Senate Budget and Fiscal Review— Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Richard Roth, Chair

Senator Janet Nguyen
Senator Richard Pan

Thursday, April 23, 2015
9:30 a.m. or Upon Adjournment of Session
Rose Ann Vuich Hearing Room 2040

Consultant: Mark Ibele

Agenda—Part A

State Finance

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.

Vote-Only Calendar

7730 Franchise Tax Board

Issue 1: Enterprise Data to Revenue Project—Information Technology (BCP 2)

Governor's Proposal: The budget proposes $44.7 million and 20 three-year, limited-term positions in 2015-16 to continue the implementation of Enterprise Data to Revenue (EDR) project of the Franchise Tax Board (FTB). Of the total budgeted amount, $41.2 million constitutes the vendor payment, with the remainder slated for personnel costs and to pay for project oversight by the California Department of Technology (CalTech). The budget proposal includes a placeholder for the project's 2016-17 requirements, which includes $53.6 million for maintenance and operations (with $39.9 million earmarked for vendor payments). As indicated in the prior agenda on this issue, the vendor payment is directly tied to revenues generated. Revenues generated by the project for 2015-16 are expected to be between $760.5 million and $1.1 billion. The 20 limited-term positions will support the ongoing current information technology (IT) work associated with the project. The positions will also facilitate and address knowledge management, transition of the system, and training. The efforts are designed to prepare FTB staff to take over maintenance and operations of EDR by January 1, 2017.

Staff Comments: This issue was discussed at the March 26, 2015 hearing date. Staff has no concerns with the proposal.

Staff Recommendation: Approve as budgeted.

Vote:

Issue 2: Enterprise Data to Revenue Project—Program (BCP 3)

Governor's Proposal: The budget proposes $2.5 million and 33 positions (25 permanent and eight two-year, limited-term) to support the Fraud Unit and Authenticated Live Chat associated with the EDR, and budget bill language. The EDR project includes enhanced fraud modeling tools that will allow the FTB to better detect fraudulent activity and stop an additional $40 million in refund and identity theft fraud returns from being issued to fraud perpetrators. The 25 permanent positions will be assigned to this unit. The proposal includes the provision of resources to Authenticated Live Chat, which will permit the exchange of personal tax information, and is expected to be implemented by July 1, 2015. The eight limited-term positions will be assigned to this activity. The proposal also calls for budget bill language which would allow the Department of Finance (DOF) to augment the department's budget by up to $3.5 million, upon 30 days' notice to the Joint Legislative Budget Committee, to provide additional resources to the EDR project for tax data preparation and capture of information from personal income tax and corporation tax documentation.

Staff Comments: This issue was discussed at the March 26, 2015 hearing. Staff has no concerns with the proposal. The proposed budget bill language is similar to that which the Legislature approved last year.

Staff Recommendation: Approve as budgeted.

Vote:

0860 Board of Equalization and Other Departments

Issue 1: Revenue Recovery and Collaborative Enforcement Plan (Supplemental Report Language)

Background: In AB 576 (V. Manuel Pérez), Chapter 614, Statutes of 2013, the Legislature established the Revenue Recovery and Collaborative Enforcement Team (RRACE), intended to enhance existing efforts to combat criminal tax evasion associated with underground economic activities by institutionalizing collaboration among state agencies. RRACE membership comprises: 1) Franchise Tax Board; 2) Department of Justice; 3) State Board of Equalization; and 4) Employment Development Department. In addition, the following agencies may participate in the pilot program in an advisory capacity to the team: 1) California Health and Human Services Agency; 2) Department of Consumer Affairs; 3) Department of Industrial Relations; 4) Department of Insurance; and 5) Department of Motor Vehicles. A key element of the effort is to facilitate data and intelligence sharing among participating state agencies.

The legislation requires that the participating agencies develop a plan for a central intake process and organizational structure to document, review, and evaluate data and complaints. The date for the development of the plan is not specified in statute or otherwise. The item was discussed at the March 26, 2015, Subcommittee No. 4 hearing and the committee indicated that the plan should be completed by December 31, 2015.

Staff Comments: Staff recommends the adoption of supplemental report language that would direct the completion of the plan:

> *Pursuant to AB 576 (V. Manuel Perez), Chapter 614, Statutes of 2013, the Revenue Recovery and Collaborative Enforcement Team (RRACE) was established in state government as a pilot program. As set forth in statute, RRACE is required to develop a plan for a central intake process and organizational structure to document, review, and evaluate data and complaints. This plan shall be presented in report form and provided to the Senate Committee on Budget and Fiscal Review, the Assembly Committee on Budget, the Senate Committee on Governance and Finance and the Assembly Committee on Revenue & Taxation on or before December 31, 2015.*

Staff Recommendation: Approve proposed supplemental report language.

Vote:

0985 California School Finance Authority

Issue 1: Federal Funds Audit Requirement (Spring Finance Letter)

Background: Federal law requires annual single audits for state authorities that administer certain federal funds, such as those administered by the California School Finance Authority (CSFA).

Governor's Proposal: The Spring Finance Letter request $35,000 (Federal Trust Funds) to cover the costs of complying with an annual single audit requirement.

Staff Comments: Staff has no concerns with the proposal.

Staff Recommendation: Approve as budgeted.

Vote:

Discussion / Vote Calendar

0860 Board of Equalization

Issue 1: Prepaid Mobile Telephony Services (Spring Finance Letter)

Background: The provisions of AB 1717 (Perea), Chapter 885, Statutes of 2014, impose a new Mobile Telephony Service (MTS) surcharge and local charge to be administered by the Board of Equalization (BOE) beginning January 1, 2016. The statute sunsets January 1, 2020. The prepaid MTS surcharge and local charges are imposed upon the consumer of prepaid MTS, but are required to be collected by the retail seller and the direct seller. The program for retailers of prepaid MTS will be administered by the Sales and Use Tax Department of the BOE, while the program that applies to direct sellers will be administered by the Special Taxes and Fees Department.

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

Governor's Proposal: The budget proposes $5.7 million (special funds) and 22.3 positions in 2015-16 and $2.6 million (special funds) and 18.9 positions in 2016-17, and ongoing, to implement the provisions of AB 1717. Except for five limited-term positions, all the positions would be permanent. In addition, there is a proposal for budget bill language that would allow for a budget augmentation upon approval of the Department of Finance (DOF) and 30 notification to the Joint Legislative Budget Committee (JLBC). The program is a new one for BOE, and administrative start-up costs will be funded through a temporary loan (addressed in the following issue) from the General Fund which will be repaid, in the same budget year, once fee revenue is generated.

The program will require that sellers of MTS register with the BOE, collect the prepaid MTS surcharge from consumers, and remit amounts collected to the BOE. Administration of the new surcharge will be conducted by Sales and Use Tax Department of BOE, but the surcharge falls under the Fee Collection Procedures Law, and will require several additional functions. Activities required for the implementation and administration of the surcharge will affect registration, return processing, collections, audits, appeals, and refunds.

- **Registration.** Some sellers of MTS do not sell personal tangible property, so they will need to be registered with BOE. This will require preparation and distribution of registration materials and information, along with necessary returns and reporting schedules.

- **Return Processing.** The program will require additional programming to the Integrated Revenue Information System. The surcharge will be reported on a separate return, requiring a new e-file return for retail sellers of MTS. Both state and local rates are subject to change, requiring annual testing. Return processing must also incorporate deposits to the 911 and PUC accounts and address direct and retail sellers.

- **Collections and Audits.** The program will result in additional delinquencies from surcharge payers. In addition, the guaranteed funding of 911 surcharges will require BOE calculations regarding any potential deficiency determination and subsequent billing. Additional audits may be required at the end of the three-year cycle, but no resources have been requested at this time.

- **Appeals and Refunds.** The program may generate additional activity for these programs, but no additional resources have been requested at this time.

Given the distribution of anticipated activity required by the surcharge, the proposal calls for: two permanent accounting and administrative positions; seven permanent positions for technology services for the legacy system; three limited-term programmer analysts; two permanent positions for technology system maintenance and operations; two limited-term and two permanent positions for information system analysis; two permanent business tax representatives for training and tax issues; one permanent outreach coordinator; two permanent business tax representatives for return analysis; five permanent positions for the local revenue and allocation unit; one permanent position for compliance and technology; one permanent position for audit and information activities; and one permanent position for special taxes and fees.

Staff Comments: The wide range and duplication of many of the activities covered in the proposal is—if nothing else—a strong indicator of the need for a more unified and comprehensive approach to tax and fee administration for the agency. Initial estimates for the implementation of the program were almost twice the amount now requested, and DOF has succeeded in refashioning the administration of the surcharge in a manner that is more cost effective than originally conceived by the agency. Nevertheless, the proposal could potentially be further curtailed by converting additional permanent positions to limited-term, in particular, the positions related to training and outreach. BOE indicates that it is requesting permanent positions instead of limited-term "due to difficulties in hiring and retaining staff." In addition, the proposed budget bill language imposes no additional criteria on the allocation of additional funds. The committee could consider additional restrictions, such as a limitation on the amount. DOF has indicated a willingness to consider amendments to the language in this regard and has suggested the changes noted below:

0860-001-3251—For support of State Board of Equalization payable from the Prepaid Mobile Telephony Services Surcharge Fund………………………..2,358,000
Schedule:
(1) 0570—Administration of the Board of Equalization……….2,358,000

Provisions:

1. The Department of Finance may augment the amounts appropriated in Schedule (1) by up to $1,000,000 to implement Chapter 885 of the Statutes of 2014, if the number of registered retailers is expected to exceed 6,500 and it is determined that the Board of Equalization requires additional resources to implement the statute. The Department of Finance shall authorize the augmentation not sooner than 30 days after notification in writing to the Joint Legislative Budget Committee.

0860-001-3270—For support of State Board of Equalization payable from the Local Charges for Prepaid Mobile Telephony Service Fund…………….….3,265,000
Schedule:
(1) 0570—Administration of the Board of Equalization……….3,265,000
Provisions:

1. The Department of Finance may augment the amounts appropriated in Schedule (1) by up to $1,000,000 to implement Chapter 885 of the Statutes of 2014, if the number of registered retailers is expected to exceed 6,500 and it is determined that the Board of Equalization requires additional resources to implement the statute. The Department of Finance shall authorize the augmentation not sooner than 30 days after notification in writing to the Joint Legislative Budget Committee.

Questions:

Board of Equalization

1. Can you relate the new program to the implementation of Centralized Revenue Opportunity System (CROS)? Will the program be designed such that it can easily be incorporated into CROS?

2. If there is not a means of seamlessly—or at least easily—incorporating into CROS, is there an approach to implementing the program such that the system does not need to be re-created once CROS comes on line?

3. In the past, the agency has asserted hiring problems associated with limited-term positions. Can you provide information about positions that are unfilled because of this or implementation of programs that have been jeopardized due to the limited-term requirement?

Staff Recommendation: Hold open.

Vote:

Issue 2: Prepaid Mobile Telephony Services (Trailer Bill Language)

Background: The background regarding Prepaid Mobile Telephony Services (MTS) established pursuant to AB 1717 (Perea), Chapter 885, Statutes of 2014, is presented in the previous issue.

Governor's Proposal: The Governor has proposed clean-up language to AB 1717 that would address three issues: allow for a *de minimis* sales threshold for retailers of MTS; a temporary General Fund loan for cash flow purposes; and, direct fee revenue to the appropriate funds. Specifically, the proposal would establish:

- ***De Minimis* Amount.** Establishes that retailers with MTS annual sales of less than $15,000 are not required to collect the surcharge or local charge.

- **General Fund Loan Authorization.** Allows for a loan from the General Fund to address cash flow issues and specifies that the loan is to be repaid in the same fiscal year, or delayed until six months after the adoption of the budget act in the subsequent fiscal year.

- **Technical Changes and Clarifications.** Specifies the accounts and funds for the deposit of the surcharge and local charge revenues, clarifies dates regarding the imposition of rates, and indicates the means by which service suppliers are notified of rates.

Staff Comments: Staff has no fundamental concerns with the proposal. However, there are a few areas in the language that could benefit from some additional specificity. For example, the $15,000 threshold may be adjusted Department of Finance (DOF) to "reflect any necessary changes." DOF indicates that the purpose of this clause is to allow some flexibility such the threshold is neither too high nor too low to adequately fund the costs of the program, and staff suggests that this more specific guideline be incorporated in the proposal.

Staff Recommendation: Hold open.

Vote:

0950 State Treasurer's Office

Issue 1: Personal Services Funding (Spring Finance Letter)

Background: The State Treasurer's Office (STO) serves as the state's asset manager, banker, and financier. It is responsible for providing banking services including: ensuring fund safety, maintaining liquidity, minimizing borrowing costs, maximizing investment returns, investing temporarily idle funds, administrating bond sales, and processing warrants. The STO notes that in 1990-91 it administered $180 billion in security investment transactions and administered the sale of $12 billion in bonds with a staff of 225. Volume has increased, such that in 2013-14, the figures were $271 billion in investments and $24 billion in bond sales with basically static staffing of 228. In addition, while the staffing characteristics for the department has generally been upgraded during this period, the funds with which to provide additional compensation were not provided until 2008. Subsequent to this, fiscal restraints eroded the augmentations slated for compensation support.

Governor's Proposal: The proposal would provide additional funding of $650,000 for compensation for existing STO staff in authorized positions. This would include compensation based on increased staff responsibilities, annual merit salary adjustments, and various unallocated budget adjustments. Currently, three divisions are deficient in their personal services budges: public finance division; information technology division; and, executive office. Funding for the proposals is based on reimbursements and funding from various boards, commissions and authority under the purview of the State Treasurer. No General Fund resources are proposed.

Staff Comments: LAO indicates that it is not uncommon for departments to periodically have higher than expected personal services costs, but that departments are expected to manage their authorized positions within their budgeted authority. Additionally, LAO expresses concern that this proposal may not address the underlying causes of STO's personal services deficiency.

While acknowledging the overall validity of LAO representations, staff notes that the activities included in the proposal involve more than general administration and program delivery, but rather professional services related to core costs of financing government. STO capital markets activities involve engagement in a highly technical and protean field, and while the state cannot compete directly with the compensation packages typical of private industry, the state should be as competitive as possible within the confines of the civil service system. Moreover, given the increase in volume and complexity of STO activities, an increase in compensation commensurate with these duties is warranted. Currently, vacant positions are often filled above the entry level, and there are ongoing difficulties in competing for talent with private sector employers.

Staff Recommendation: Approve as budgeted.

Vote:

Issue 2: Strategic Information Technology Initiatives (Spring Finance Letter)

Background: The STO is attempting to improve the accessibility to services, data and information provided, as well as to improve and upgrade its information technology (IT) capabilities. The proposal will realign funding in accordance with benefits received and would be consistent with the Treasurer's strategic plan.

Governor's Proposal: The proposal from the STO, approved by the Administration, calls for upgrading and improving several components of the STO IT technical services. For the entire proposal, 11 new positions in three areas (discussed below) would be established, with additional required resources of $1.4 million (reimbursements and special funds).

- Five additional positions for the Data and Government Transparency Unit, to redesign and expand the STO's public website and interfaces with various databases.

- Three additional positions for the Project Management Office, to establish a permanent presence at the STO, in response to a request from the California Department of Technology (CalTech).

- Three positions for technical support services, to address additional workload from the prior Administration, and manage the conversion from obsolete and dated systems.

Legislative Analyst's Perspective: LAO recommends rejecting the proposed funding and positions for a Data & Government Transparency Unit to redesign STO's website and the Project Management Office. It indicates STO has not clearly demonstrated that the website modifications that it proposes justify the additional costs of five staff on an ongoing basis, nor has STO identified sufficient ongoing project management needs to justify three positions for this workload on an ongoing basis. LAO indicates it would be more appropriate for these positions to be considered during the January budget process allowing for additional time to further refine the plan and justification for these new units, and provide the Legislature with additional opportunity to more fully evaluate STO's request.

Staff Comments: The STO proposals to increase transparency and upgrade project management capabilities are laudable, as is the increased focus on IT performance. However, staff is in general agreement with LAO recommendation regarding the Data and Government Transparency Unit, in that this proposal could benefit from additional germination allowing for refinements. Nevertheless, some preliminary scoping of this area could be accomplished prior to the formulation of a follow-up proposal (presumably as part of the January 2016 budget), and thus, a limited amount of resources could be appropriate at this time. Establishing a Project Management Office, given ongoing concerns with IT procurement, is a worthwhile investment, and the STO proposal is a reasonable approach. The IT positions, similarly, are a wise investment; however, given that some of the work associated with these positions is related to conversion to new systems and may not involve an ongoing obligation, it may be worth considering these as limited-term positions.

Staff Recommendation: Staff recommends the following: approving one initial position for Data and Government Transparency Unit; funding the requested positions for the Project Management Office; and approving funding for the two technical IT positions and the IT deputy chief, with the two technical positions provided on a limited-term basis.

Vote:

Issue 3: Letters of Credit (Trailer Bill Language)

Background: The STO Centralized Treasury and Securities Management Division operates under the provisions specified in California Government Code sections 16300 et seq. (Title 2, Division 4, Part 2). With respect to the collateralization of accounts, California Government Code allows letters of credit (LOCs) issued by the Federal Home Loan Bank of San Francisco (FHLBSF) to be received as collateral for demand deposits, fiscal agent deposits, time deposits, and state agency deposits outside of the centralized treasury system. It also allows the Federal Reserve Bank of San Francisco (FRBSF), or any of its branches, to receive deposits of securities approved by the State Treasurer for all of the programs.

References to specific bank locations of the Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) were originally placed in statute since many of the state’s depository banks were located in California, resulting in the designation of FHLBSF as their bank. In addition, FRBSF is California’s administrative reserve bank. In recent years, this proscription has presented challenges, since fully half of the state’s demand deposits reside outside California. These depositories do not have the option to use LOCs since they are not members of FHLBSF. In addition, while initially management of the State Treasure’s FRB account operations originated in the FRBSF, the FRB has consolidated these operations in FRB of Boston and FRB of Kansas City, thus placing the management of these accounts out-of-compliance with statute. In addition, the STO notes that new requirements under the third accord of Basel Committee on Banking Supervision, (Basel III) has tightened capital requirements and increased the cost of collateral to banks, which could result in added costs to the state, absent the proposed changes.

Governor’s Proposal: The proposed trailer bill language would remove restrictions and references to “San Francisco” in California Government Code sections. This would ensure that the STO is in compliance with statutes regarding the management of its account at FRB and would also enable depository banks to submit LOCs as collateral from any FHLB.

Staff Comments: Given the dispersal of financial activities, the proposal provides a needed update to existing statute. A review of other large states—including New York, Texas and Florida—confirmed that these states have already liberalized their LOC policies. Staff has no concerns with the proposal. There is no known opposition.

Staff Recommendation: Approve the proposed trailer bill language.

Vote:

0984 California Secure Choice Retirement Savings Investment Board

Issue 1: Legal Services and Market and Financial Feasibility Study (Spring Finance Letter)

Background: The California Secure Choice Retirement Savings Investment Board and the California Secure Choice Retirement Saving Program were established pursuant to SB 1234 (De León), Chapter 734, Statutes of 2012, for the purpose of creating a statewide savings plan for private-sector workers who lack access to an employer-sponsored retirement savings plan. The legislation requires that the board to conduct a market analysis and financial feasibility study and legal analysis to determine whether the necessary conditions for implementation of the program can be met. The board is required to conduct the analyses only if funds are made available through a nonprofit or private entity, or from federal funding. The board can implement the program only if it determines, based on the market analysis, that the program will be self-sustaining; funds are made available through a nonprofit or other private entity, federal funding, or an annual budget act appropriation in amounts sufficient to allow the board to implement the program until the California Secure Choice Retirement Savings Trust has sufficient funds to be self-sustaining; and an authorizing statute is enacted that expresses the approval of the Legislature for the Program to be fully implemented.

The board will be entering into a legal contract for $275,000 which will be in place in the spring of 2015. The board expects to interview finalist firms for the market analyses and financial feasibility study in the spring of 2015, with the contract in place in April of 2015. The board expects both studies to be completed by fall 2015. The studies and analyses must be paid for only through donated funds, of which the board has received $572,000 as of January 2015. The board indicates that written agreements for matching funds and ‘verbal assurances’ from potential funding sources make the board optimistic that it will achieve the funding goal.

Governor’s Proposal: The budget proposes an appropriation of $1.0 million (donated funds) for the purposes of conducting a market analysis, financial feasibility study and legal analysis for the California Secure Choice Retirement Saving Program. In addition, budget bill language is proposed to allow for the additional expenditure authority, if additional private funds are available, upon approval of Department of Finance (DOF) and notification to the Joint Legislative Budget Committee.

Staff Comments: Support for the program must come from donated funds. Staff has no concerns with the proposal, except for potential refinements to budget bill language to address the potentiality of resources that could potentially be less than $1.0 million. In particular, verbal assurances may not be a sufficient basis for an appropriation.

Questions:

California Secure Choice Retirement Savings Investment Board:

1. Retirement programs are closely governed in terms of security and tax implications at the federal level. Are there any outstanding issues related to federal oversight or legal requirements that might affect the program?

2. How much has the board received in contributions to date?

Staff Recommendation: Approve as budgeted.

Vote:

0989 California Educational Facilities Authority

Issue 1: Administration of College Access Tax Credit Fund (Spring Finance Letter)

Background: The California Educational Facilities Authority (CEFA) was established in part for the purpose of providing students with better access and opportunities in higher education by providing assistance with capital financing needs. In addition, CEFA's charge was expanded to include the financing of student loan borrowing programs. CEFA activities were further expanded through SB 798 (De León), Chapter 367, Statutes of 2014, which created the College Access Tax Credit Fund (CATCF), for the purposes of attracting private contributions to fund additional Cal Grants. The legislation allows a tax credit equal to 60 percent in 2014, 55 percent in 2015, and 50 percent in 2016 for contributions to the fund. The maximum amount of credit that may be allocated during any year is $500 million.

Under SB 798, CEFA is required to carry out a number of administrative activities in furtherance of the program. Specifically, the major duties include:

- Allocate and certify the credit to personal and corporate taxpayers from January 1, 2014 to December 31, 2016.
- Certify the contribution amounts eligible for the credit within 45 days following the receipt of the contribution.
- Establish a procedure for taxpayers to contribute to the fund and obtain certification for the credit.
- Provide to Franchise Tax Board (FTB) a copy of each credit certification by March 1 of the calendar year immediately following the year of issue.

Governor's Proposal: The budget proposal calls for $244,000 and one position for the board and $134,000 and one position for the State Treasurer's Office (STO) in the budget year to administer the program. All resources are special funds and reimbursements. The two positions are limited-term and consist of associate treasury program officer and accounting officer. Duties include allocation and certification of the credits, certification of contribution amounts, managing and assisting in procedures for taxpayers, preparing and providing certification documentation, monitoring taxpayer contributions, preparing and providing technical information, and performing research.

Staff Comments: Staff has no concerns with this proposal.

Staff Recommendation: Approve as budgeted.

Vote:

7730 Franchise Tax Board

Issue 1: Enterprise Data to Revenue Project—Risk Mitigation (Spring Finance Letter)

Background: The Franchise Tax Board (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. 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. The project is 70 percent complete at this point and FTB indicates project revenue is 194 percent over the original estimates.

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.

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.

Contractor payment for system development and implementation are 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 made use of revenue gains from reducing the business entity backlog to more than offset costs in 2009-10 through 2012-13. Cleaning up the backlog was a necessary condition to efficient project development. In subsequent years, there have been large increases in annual revenue gains that are directly attributable to the IT project. For 2010-11 through 2013-14, revenue projections were $444 million, but actual revenue generated was $863 million. FTB expects that the projected $4.7 billion of additional revenue through the life of the project (terminating in 2017-18) will be realized. The benefits method of financing EDR is similar to that used by the Employment Development Department (EDD).

Governor's Proposal: The department has requested $6.1 million and 17 limited-term positions in 2015-16 and proposed EDR changes that will allow it to take risk mitigation actions necessary to meet program objectives. The proposed changes incorporated in the proposal are the following:

- **Business Entities Return Analysis (BERA) Ramp-up Approach.** $3.0 million is slated for this component, which will include a methodical approach to the implementation of return validation for business entities. Funding will be used for the vendor's specialized staff for the slow roll-out of the program incorporating adjustments on an as-you-go basis. The total cost of $6.0 million is shared equally by the state and the vendor.

- **Temporary Help Positions for Ramp-Up Approach for BERA.** $791,000 is for limited personnel for the methodical implementation of the return analysis for business entities. The approach minimizes risks by keeping volume low initially and increasing volume as processing issues are addressed.

- **Up-Grade Vendor Staff Expertise to Support Knowledge Management Transfer.** $2.3 million is set-aside to retain vendor key staff with specialized expertise during the budget year (instead of more generalized personnel as called for in the contract). This will allow the knowledge transfer of the program to shift to FTB in a more comprehensive fashion and time and resources to understand the key and complex features of EDR.

Staff Comments: The proposal would not result in additional functionality of the EDR system; rather the proposal represents 'insurance' as a means of mitigating risk. It is possible that a more rapid incorporation of return analysis would be less costly—if everything went well. The slow methodical incorporation on a risk-return basis seems a much more prudent approach. Similarly, purchased 'specialize' expertise rather than 'general' is an investment that should improve FTB understanding and operational capabilities of a complex and powerful data technology project. The department has provided an overview of the project at the March 26, 2015 hearing of this subcommittee, as has the Department of Technology. The project is on track, and staff has no concerns with this proposal.

Staff Recommendation: Approve as budgeted.

Vote: