Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Gloria Negrete McLeod, Chair
Senator Noreen Evans
Senator Doug La Malfa

Thursday, May 24, 2012
10 a.m.
Room 3191
Consultants: Brady Van Engelen / Mark Ibele

Items Proposed for Discussion and Vote

Item Number and Department

0502	California Technology Agency
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0860	Board of Equalization
0890	Secretary of State
1110	State Consumer Services Agency
1700	Department of Fair Employment and Housing
2240	Department of Housing and Community Development
8880	FI$CAL
8885	Commission on State Mandates
8940	California Military Department
9210	Local Government Financing

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Issues Proposed for Discussion / Vote

8880 FINANCIAL INFORMATION SYSTEM FOR CALIFORNIA (FI$CAL)

Background: The Financial Information System for California (FI$Cal), is an Enterprise Resource Planning (ERP) information technology (IT) project intended to replace, consolidate, and upgrade multiple legacy financial systems with a single system that would encompass the areas of: budgeting; accounting; procurement; cash management; and financial management. The development of FI$Cal resides with four "Partner Agencies," the Department of Finance, the State Treasurer's Office, the State Controller's Office, and the Department of General Services. The FI$Cal system has been in development for several years, but is now at a critical juncture because the Administration selected a contractor or "systems integrator" on March 1, 2012, to implement the system. To move forward with the contract and expenditures, legislative approval is required. Included in this budget item is funding for the contract staff and State staff that manage the project, and funding for the selected systems integrator, which is Accenture. Accenture would implement this ERP IT system using Oracle's PeopleSoft software.

Previous Subcommittee Hearing: On March 8, 2012, the Subcommittee heard the FI$Cal project, including the Governor's budget request and March Finance Letter that requested $89 million ($53.5 million General Fund) for the budget year. The state has expended $94.8 million on the FI$Cal project through the current fiscal year. At that hearing, the Subcommittee heard that the overall project costs through 2017-18 would be $616.8 million over the life of the program allocated as follows:

- $295.7 million for project staff (both State staff and contract staff);
- $213.1 million for the Accenture contract; and
- $19 million for state data center services.

The Subcommittee also learned that upon completion of the project, ongoing annual operations and maintenance costs would be $32.5 million (all funds).

The Subcommittee also discussed the overall rationale for the project, including the estimated annual savings and/or cost avoidance of $415 million from the following:

- Process cost savings of $173.2 million from efficiency and productivity improvements.

- Technology cost savings of $28 million from retiring outdated legacy systems that are expensive and difficult to maintain.

- Procurement effectiveness savings of $213.4 million from better procurement management and consolidated purchasing.

- Risk reduction and system failure costs are not quantified, but FI$Cal is expected to replace dozens of systems that are at a high risk of failure because of their age and outdated software platforms.

- Business performance improvement is also not quantified, but FI$Cal is expected to yield additional savings due to the enhanced financial management tools available in the new system, including the ability to implement performance budgeting-type systems.

The Subcommittee discussed the Administration's decision to fund the FI$Cal project using a pay-as-you-go methodology as opposed to vendor or bond financing alternatives. The financing alternatives would have resulted in increased interest charges and the Administration also indicated that only about half of the project costs would have been financeable. The Subcommittee also discussed a staff alternative for funding the FI$Cal project that would eliminate GF expenditures in the budget year and would instead accelerate expenditures from various special funds and nongovernmental cost funds to cover the investments required for the project in 2012-13.

May Revision: The Governor has submitted a May Revision letter on the FI$Cal system that adopts a version of the staff alternative presented to the Subcommittee on March 8, 2012. This letter continues to request the same $89 million requested in the March Finance Letter, but instead eliminates all General Fund for the project by shifting $53.5 million to various special and nongovernmental cost funds. The May Revision also proposes to make two technical adjustments as follows:

- Eliminates two pieces of provisional language that would have allowed the Department of Finance to adjust total expenditures for the project to adjust to an approved Special Project Report (SPR). The SPR has already been submitted and approved by the California Technology Agency and these provisions are no longer needed.

- Requests additional provisional language that would allow the Department of Finance to increase GF expenditures on the project only if special and nongovernmental cost funds are not sufficient to cover the costs of the project. Any adjustments authorized pursuant to this section would require notification of the Joint Legislative Budget Committee prior to authorization.

- Additional Reviews Received. Since the March 8, 2012 hearing, two reviews of the FI$Cal project have been received by the Legislature, including a review by the Bureau of State Audits (BSA) and the Legislative Analyst's Office (LAO).

- The BSA independently monitored the entire FI$Cal procurement, a unique requirement placed on the project by the Legislature because of the size and risk of the project. In this review, dated April 26, 2012, the BSA made the following recommendations:

- Require FI$Cal to track the costs of department subject matter expert staff time spent on FI$Cal. The final project does not have dedicated funding for each department (beyond the core partner agencies). Non-partner agencies will be expected to absorb time related to providing subject matter expertise on business processes from within existing resources.

- Require FI$Cal to report annually on the benefits achieved and any changes in total projected benefits. The FI$Cal project engaged a firm to do the initial benchmarking study that projected the expected project benefits reported earlier in this agenda, but the project has indicated that annual tracking will require additional studies based on actual implementation.

- Require FI$Cal to report annually on the cost and reasons for any significant customizations to the software that were not anticipated at the onset of FI$Cal implementation.

The LAO also released a comprehensive study on the FI$Cal project dated April 30, 2012. In this report the LAO recommended that the Legislature approve the project going forward. The LAO described funding strategies that would minimize GF expenditures in the early years of implementing the project. The Administration has adopted a variation of this strategy in the May Revision. While the LAO indicated that the FI$Cal staff had made significant progress in mitigating risk and better defining cost of the project, they did make two recommendations that they thought would further strengthen the project. Specifically they recommended that project staff do the following:

- Develop a more comprehensive and detailed change management plan; and

- Take efforts to ensure that departments have adequate staffing to assist with a smooth transition to FI$Cal.

Staff Comments: Staff finds that there has been considerable discussion about the FI$Cal project starting in 2005. Since that time, the project costs have been reduced significantly and project staff has made considerable efforts to minimize risk to the project. Even so, ERP projects are considerable undertakings that sometimes require significant change in business processes. Both the BSA and LAO have raised some concerns about the staff time that will be required at the non-partner agencies required to implement this system. The change management planning, training, and leadership in the non-partner agencies will be crucial to ensure smooth and successful implementation of the system. Furthermore, there are literally thousands of deliverables and details that will go into implementing the FI$Cal system. Given this, there are bound to be changes and adjustments that are required to keep the project on track. Therefore, staff finds that ongoing Legislative oversight of this project, as it is implemented over the next six years, is critical. The oversight will be especially critical related to change management at the non-partner agencies as they get ready to implement the new system.

Staff Recommendation: Staff recommends that the Subcommittee take the following actions:

- Approve March Finance Letter.

- Approve May Revision Letter that eliminates GF requested in the March Finance Letter including requested changes to Provisional Language.

- Approve placeholder trailer bill language that requires ongoing annual reporting to the Legislature on the status of the project, including modifications made to the project plan and change management activities.

0890 CALIFORNIA SECRETARY OF STATE

Issue 1 – CAL-ACCESS and CALVOTER Server Stability

Governor's Budget Request: The Governor's May Revise includes a request to augment $375,000 ($206,000 General Fund) in Fiscal Year 2012-13 and $95,000 ($66,000 General Fund) in 2013-14 to purchase servers, software licenses, and to contract for services to address failing operating systems related to the Cal-Access and CalVoter databases. The Secretary of State's Office (SOS) states that this request is required to comply with the California Political Reform Act of 1974 and the Help America Vote Act of 2002.

Background: Created in 1999, Cal-Access is a database maintained by the Secretary of State's Office used to make lobbying and campaign finance information available to the public. CalVoter is a database containing voter registration information. Both systems are run on servers that are more than 12 years old, and are the only two of nine Secretary of State Information technology programs that have not been updated since 2010.

The Cal-Access system went down on November 30, 2011, and again on December 9, 2011. The system was restored on December 30, 2011 through a process called virtualization, which runs the system by creating a new system on new servers and software to emulate the old system.

CalVoter cannot be operated at full capacity while the Cal-Access system is operated in its current state. To address this issue, SOS proposes to separate the two systems onto different servers. SOS proposes to spend $130,000 on new servers, $130,000 on a virtualization software license, and $40,000 on contract services in 2012-13. Another $20,000 in contract services for 2013-14 is proposed.

SOS believes this proposal will allow it to operate these systems through the 2012 election cycle. In addition, SOS proposes to temporarily relocate the operating systems in January 2013, at a cost of $75,000 in 2012-13 and another $75,000 in 2013-14.

Staff Comment: It is worth noting that the solutions provided are temporary. The Secretary of State will need to identify a more permanent solution to resolve both Cal-Access and CalVoter. CalVoter will transition to VoteCal in the near future, but a permanent solution for Cal-Access will still need to be identified.

Staff Recommendation: Approve May Revise request.

Issue 2 – Statement of Interests Backlog

Governor's Budget Request: The Governor's May Revise includes a request for a two-year limited augmentation of $947,000 in Reimbursement authority to more quickly fill positions and allow for paid overtime to reduce the backlog regarding processing annual Statement of Information documents filed by businesses.

Background: Corporations and limited liability companies are required to file an annual Statement of Interest with the Secretary of State's Business Programs Division that contains information regarding the business and its key personnel. Filed Statements of Information are used by businesses to open checking accounts and enter into contracts.

Businesses pay a fee when submitting this form, and they can pay a higher fee for expedited service. The Secretary of State has noted that it has 100,000 Statements of Information waiting to be opened and processed, many of which have a check for $20 to $25 attached. Current processing procedures are completed manually.

The Secretary of State has proposed to use funding from expedited fees, which are deposited in the office's Reimbursements account, to quickly fill positions and pay overtime to decrease the current 117-day turnaround time for processing Statements of Interest. This will not increase fees and is only a request to expend existing funds.

Staff Comment: At its April 26th hearing, the Senate Budget and Fiscal Review Subcommittee No. 4 heard a similar issue related to the request of $1.1 million in Business Fees Funds to accelerate the processes related to Business Formation Documents. This is a similar request related to the Secretary of State's processes for addressing Statements of Interest, which are filed annually.

California Business Connect project, which will automate the filing and retrieval of business documents and create a centralized database for all business records is expected to be completed by June 2016.

Staff Recommendation: Approve the May Revise request

0890 STATE CONTROLLER'S OFFICE

Department Overview: The State Controller is the Chief Fiscal Officer of California. The State Controller's Office (SCO) is a separately established constitutional office. The Controller chairs or serves on 81 state boards and commissions, and is charged with duties ranging from participating in the oversight of the administration of the nation's two largest public pension funds, to protecting the coastline, and helping to build hospitals. The Controller provides fiscal control for, and independent oversight of, more than $100 billion in receipts and disbursements of public funds. In addition, the Controller offers fiscal guidance to local governments, and performs audit functions to uncover fraud and abuse of taxpayer dollars. The SCO's primary objectives are to:

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

Issue 1 – Fraudulent Claims Detection and Prevention Program

Governor's Budget Request: The Governor's 2012-13 Budget includes a request for 17.9 permanent positions and $2.28 million in 2012-13 and ongoing from the Unclaimed Property Fund to establish a unit within the Unclaimed Property Program designed to detect and prevent fraudulent unclaimed property from being paid.

Background: Under current law, the State Controller's Office is responsible for safeguarding unclaimed property until it is returned to the lawful owner. The Unclaimed Property Division (UPD) of the State Controller's Office reunites owners with their lost or abandoned property when the owner files a paper claim following a search for property on the State Controller's website or after calling the Unclaimed Property Division call center to request a claim form. A claim may be filed by either the owner or the heir of the owner as reported by the holder.

Staff Comment: This item was originally heard in Senate Budget and Fiscal Review Subcommittee No. 4 on April 26th. At that time staff had addressed concerns about approving this request as an ongoing appropriation. The request will be scaled down to a pilot project with

Supplemental Reporting Language asking for updates on the progress of the Unclaimed Property Program.

Staff Recommendation: Approve as a two-year limited term pilot with Supplemental Reporting Language to report on progress.

Issue 2 – Integrated Data Management System Cost Increase

Governor's Budget Request: The Governor's May Revise included a request for $201,000 ($47,000 General Fund, $97,000 reimbursements and $57,000 Special Fund) for 2011-12 and $902,000 ($207,000 General Fund, $437,000 reimbursement and $258,000 Special Funds) in 2012-13 to fund increased Office of Technology Data Center costs to support Computer Associate Integrated Data Management System (IDMS)Technology services. This request reflects a minor reduction in costs to support the Integrated Data Management System.

Background: The State Controller's Office has requested the additional support to maintain an existing information system for three departments (State Controller's Office, California Highway Patrol, and California State Teachers Retirement System) while these departments complete their own information technology improvements. The Office of Technology will no longer offer IDMS as a shared service as of March 31, 2012. The service will be offered as a dedicated service to the three agencies continuing to use this system. As part of the State Controller's Office ongoing technology improvements, the IDMS capabilities will be transitioned in the future.

Staff Comment: This item was held open at the Senate Budget and Fiscal Review Subcommittee No. 4 an April 26th with the understanding that there would be a slight decrease in the costs associated with the support of the Integrated Data Management System.

Staff Recommendation: Approve May Revise request.

Issue 3 – Increased Audit Workload

Governor's Budget Request: The Governor's 2012-13 Budget includes a request for $2.09 million ($1.42 permanent and $673,000 one-year limited-term) in reimbursement authority to support 12.6 existing positions and 7.4 new positions (1.1 permanent positions and 6.3 one-year limited term) beginning in 2012-13.

April 1 Finance Letter: In addition to the original positions requested to support the audit workload, the State Controller's Office has requested an additional $1.75 million ($856,000 one-year limited-term and $899,000 five year limited-term) in reimbursement authority to support 8.0 existing positions and 7.4 new positions (8.0 one-year limited-term and 7.4 five-year limited-term) beginning in 2012-13. Included within this request was the request for support of 8.0 positions and $856,000 in reimbursements in 2012-13 to perform federally-mandated audits of the Disproportionate Share Hospital program, administered by the Department of Health Care Services.

Background: Both proposals would either maintain or, in some cases, increase the presence of auditing the following programs:

- **Women, Infants and Children (WIC)** – Vendors participating in the program administered by the California Department of Public Health (CPDH). The January Budget request was for 12.6 positions with $1.3 million in reimbursements in order for CPDH (which contracts with the State Controller's Office) to maintain the increased auditing requirements of the US Department of Agriculture (USDA) which runs the WIC program. The April 1 Finance Letter requested an additional $899,000 and 7.4 positions for five years for federally mandated audits of the WIC program to ensure that the state is in compliance with the requirement that five percent of the vendors be audited annually. The April 1 Finance letter also included a request for $23,000 in one-time costs for minor equipment (laptops, mobile printers).

- **California Department of Public Health (CDPH)** – CDPH financial statements, single audits of the Safe Drinking Water Revolving Fund, and the CDPH's federally funded Public Water System Supervision grant. This request is to continue the funding for 1.1 positions and $92,000 in reimbursements to continue to permanently maintain this position. The auditing presence will continue to be required in order for the state to receive the federal grant funding of $75 million annually for the program.

- **Disproportionate Share Hospital Program (DSH)** – Federally run program established to assist hospitals that serve a large number of Medicaid (Medi-Cal) and low-income patients. Through the DSH Program, the State pays a qualifying hospital a DSH payment that is in addition to the standard Medicaid payment. The State then submits a reimbursement claim to the federal government.

- **California Department of Transportation (Caltrans)** – It is anticipated that there will be additional ARRA construction costs incurred through 2012-13, which would require an auditing presence in order to comply with federal standards. This request is for the continuance of 6.3 positions and $673,000 in reimbursement authority to perform audits of the projects funded through ARRA.

Staff Comment: Members expressed concern with the originating fund source of many of the programs that the State Controller's Office is requesting to support the audit workload. The fund source for each of the items is listed below:

- **WIC**

  The originating fund source for the administration of the WIC program is federal funds. The administrative funding is separate from funding for participant benefits. The federal government requires the audits to identify and/or deter fraud, waste, and abuse by vendors participating in the WIC program.

- **Disproportionate Share Hospital (DSH) Program**

  The originating fund source for the administration of the DSH program is a mix of 50 percent federal funds and 50 percent state general fund. These funds are separate from the federal DSH Allotment provided to hospitals. The federal DSH Allotment to qualifying hospitals is contingent on the state providing an annual independent certified audit of the DSH program.

- **California Department of Public Health (CDPH) – Safe Drinking Water Revolving Fund (SDWRF)**

  The originating fund source for these audits is SDWRF accounts, which are 80 percent federally funded with a 20 percent state match. The state match has, in both prior and current years, come from Proposition funds. In future years it will come from Revenue Bonds. The amount allocated to "recipients" (i.e., the local water districts) is not reduced by the cost of the audits. The funding for the audit comes out of a separate administrative portion of the grant and loan awards, included to cover all CDPH administrative costs. These audits are required by the grants.

- **California Department of Public Health (CDPH) – Public Water System Supervision (PWSS)**

  The originating fund source for these audits is the federal PWSS grant. The federal PWSS grant helps pay for a portion of the CDPH's administrative cost of running the Safe Drinking Water Program. CDPH contracts with the SCO to fulfill their federal contract requirement.

- **Caltrans ARRA**

  The originating fund source for these audits is the State Highway Account State Transportation Fund. The audits do reduce the amount available in the fund. However, they fulfill an audit requirement to ensure ARRA funds are expended correctly and in compliance with federal requirements.

Staff Recommendation: Approve request included in Governor's 2012-13 Budget, approve request submitted on April 1.

Issue 4 – Airport Facility Fee Audits

Governor's Budget Request: The Governor's Budget proposes trailer bill language (TBL) that would eliminate the requirement that the Controller's Office independently review and report to the Legislature regarding the results of audits required to be conducted by airports with respect to the collection of fees to fund consolidated rental car and other transportation facilities.

Background: Under SB 1192 (Oropeza), Chapter 642, Statutes of 2010, the Legislature expanded the definition of customer facility charge to include a fee to be collected for the purpose of financing common-use transportation facilities and thus allowed the collection of an alternative fee, if necessary, for funding purposes. The bill also requires that airports that collect the fee to report certain information to the Legislature and complete a specified independent audit at particular intervals. The Controllers' Office is to independently examine the audits and substantiate the necessity for the customer facility charge. The Controller is to report the finding to the Legislature and expenses of the review are paid by the airports.

The authority to collect the customer facility fee began in 1999 with special approval for such collection granted to international airports at San Jose, San Francisco and San Diego. The Legislature expanded this to other public airports in 2001 and 2007. Under the program, each airport is required to complete an independent audit to ensure the aggregate amount of fee revenue does not exceed the reasonable costs paid by the airport to finance the design and construction of consolidated car rental facilities and common-use transportation systems. In

2010, the Legislature required that SCO review the audits and independently examine and substantiate the necessity of the customer facility fee. Thus, the audits will ensure that the fee (not to exceed $10 per contract) charged to airport car renters is not excessive.

One two-year, limited-term position was funded, resulting in $140,000 in reimbursement authority for 2010-11 and $134,000 for 2011-12 to conduct mandated independent reviews of the audits. The limited-term position expires at the end of this fiscal year. The SCO proposed to continue the funding in order to fulfill the independent review required by statute. The Administration has proposed TBL to eliminate the review requirement.

To date, the SCO has conducted an independent review of three independent CPA audits of the charges. The reviews reviewed undercharges and overcharges. For the Burbank-Glendale-Pasadena Airport Authority Audit, the review revealed that the Authority could have charged $4.4 million more than it actually did. Two other reviews—San Jose International Airport and Fresno-Yosemite International Airport—reveal overcharges of $19.5 million and $7.0 million, respectively. The overcharges were the result of unrecognized income and overstated costs.

Staff Comment: In 2011, Fresno, Burbank, and San Jose, went through the audit process as prescribed in SB 1192 (Oropeza). As noted, the bill required an outside audit on the rental car facility financing plan to be conducted by an independent auditor, and, that audit would in turn be audited by the State Controller's Office. As described in SB 1192 (Oropeza), an audit from the State Controller's Office was a necessary component of an airport's request to impose a Customer Facility Charge, a new fee authorized in the legislation.

However, there have been concerns with the review process conducted by the State Controller's Office. The California Airports Council has noted that, historically, the state has not had any oversight over the airport finance process. Understandably, the State Controller's Office, which typically has had oversight of remitters of state funds or beneficiaries of state funds, lacked the background and understanding of the process prior to the implementation of SB 1192. This additional ramp-up time led to a lengthier audit and review process, which, in some cases, hindered the ability of the airport to go the bond market to finance construction.

A point has been raised that this audit uncovered the fact that some airports were overcharging the approved Customer Facility Charge, while others were undercharging the appropriate rate. According to the California Airports Council regarding the instance of undercharging, the airport contract with the rental car companies requires them to cover any debt service shortfall, thus keeping the fee lower for rental car companies. The overcharge stemmed from the airport utilizing the fee to defease the bonds sooner, therefore eliminating the fee entirely for rental car customers sooner and saving airport financing costs.

Staff Recommendation: Adopt proposed trailer bill language.

Issue 5 – 21st Century Project

Governor's Budget Request: The Governor's May Revise included a request for 152.0 one year limited-term positions and $79.69 million ($45.31 million General Fund, $1.0 million in reimbursement authority, and $33.38 in Special Fund) to fund the 21st Century Project in 2012-13. This reflects a reduction of 29.0 positions, $1.67 million in funding ($1.56 General Fund). The May Revise also includes a request to amend Control Section 25.25 (21st Century Project) by decreasing the amount by $109,000 in 2012-13 for one year.

Background: This request reflects a continuation of 111.0 positions that have received prior approval. The May Revise reflects a reduction of 29.0 total positions. The majority of the reduction will occur in the requested level of Organization Change Management positions. A brief description of each of the requested positions is listed below:

- Project Management – The Project Management Office is composed of teams with the objective of implementation. The office's day-to-day activities include administrative support with budgets, funding and contracts, and ensuring reporting and compliance requirements are met. A quality assurance team performs its duties using methodologies designed to measure the accuracy and success of the project implementation. Advisors with expertise in large-scale Information Technology are accessible for guidance when needed.

- Business Operations - The Business Operations team monitors Project functional deadlines, milestones, work products, and deliverables. Staff manages and performs day-to-day operations for time, payroll, benefits, and configuration functions. The team also performs gap analysis and leads business processes reengineering activities including interface coordination and control agency reporting.

- Technology Operations – The Technology Operations team support's technology design, development, and the implementation of the MyCalPAYS system. Technical staff is also responsible for leading Data Conversion, Reporting, Development, Infrastructure, and Security activities.

- Organizational Change Management – The Organizational Change Management team is responsible for the execution and planning of deployment, training, workforce transition, internal and external communications, mobilization and alignment, and stakeholder management.

Staff Comment: There clearly is a need to transition from a transaction based system to an enterprise database system that better supports the business needs of the state. Unfortunately, the state's solution, the 21st Century Project, has been subject to a series of setbacks that have prolonged implementation. Upon termination with the original vendor (BearingPoint), the State Controller's Office has awarded a new contract to SAP that was approved in February 2010. This project is currently subject to approximately a twelve month delay from the approved Special Project Report 4.

In 2005, the Legislature approved the project with an estimated total cost of $130 million. Currently, total project costs, as noted in SPR 5, total $370 million dollars. Budget Year 2012-13 will remain the high-water mark in spending to support the 21st Century Project. It is expected

that there will be significantly less resources required in 2013-14 to support the 21st Century Project.

Staff Recommendation: Approve May Revise request.

Issue 6 – My CalPERS

Governor's Budget Request: The Governor's May Revision included a request of $1.5 million in 2012-13 and 15 two-year limited-term positions for workload associated with the temporary data incompatibility between the SCO and PERS computer systems.

Background: When CalPERS implemented its MyCalPERs system in 2009, the new system recorded tens of thousands of "fallout records" errors that needed to be reviewed manually. A "fallout record" occurs when the data received from the Controller does not match the data in the CalPERS computer records. These "fallout errors" are expected to continue until the Controller implements the 21st Century Project. CalPERS also reports that it is working on automation fixes in the hopes to reduce the number of these errors.

The May Revision requests $1.5 million and 15 two-year limited-term positions to address these fallout records. The Controller's office says that it reassigned staff from other SCO areas to cover this workload, but it has started to accrue backlogs in these other areas as a result of this redirection and thus believes dedicated resources should be identified to address this problem. The May Revision proposal includes budget bill language to allow the Department of Finance to reduce the staffing levels if this workload diminishes.

Staff Comment: Staff is under the impression that a temporary solution has been provided to prevent future fallouts from occurring. However, there is still a large amount of data that needs to be reviewed to address the fallouts that occurred prior to the automation fix. A smaller amount of resources should be adequate to address the records that have not matched properly. Staff recommends funding this proposal at half of the level requested in May Revise.

Staff Recommendation: Approve funding and position authority for 7 positions on a two-year limited-term basis.

0502 CALIFORNIA TECHNOLOGY AGENCY

Issue 1 – Elimination of the 9-1-1 Advisory Board

Background: The Governor's 2012-13 Budget includes a request via trailer bill language to eliminate the 9-1-1 Advisory Board. The State 9-1-1 Advisory Board is responsible for providing the Telecommunications Office with the proper policies, practices; and procedures for the California 9-1-1 Emergency Communications Office. The Governor's 2012-13 Budget has stated that the policies and procedures considered by the Board will be performed by the State's administrative process.

Staff Comment: The Board is the only publically assessable venue to present and deliberate issues related to the 911 system. This proposal has limited savings, but could have possible impact on public safety.

Staff Recommendation: Reject proposed Trailer Bill Language.

Issue 2 – Contract Oversight

Governor's Budget Request: The Governor's May Revise includes a request for an increase in expenditure authority for 2012-13 of $670,000 ($218,000 General Fund) and 5.0 positions. The Administration has submitted Trailer Bill Language accompanying this request in order to ensure that there is a requirement that the Technology Agency approve oversight contracts by state agencies.

Background: The California Technology Agency (CTA) contends that providing these services by state staff will enable CTA to develop and apply uniform criteria on high risk projects in order to reduce project risk and the potential for cost increases. Additionally, this will reduce reliance on contractors to provide oversight of technology projects, which will also result in savings to state information technology projects.

Staff Comment: Savings achieved in information technology projects will be captured through Control Section 4.05 adjustments in 2012-13, and departmental budgets will be adjusted in future years.

Staff Recommendation: Approve request and adopt placeholder Trailer Bill Language.

2310 OFFICE OF REAL ESTATE APPRAISERS

Issue 1 – Extension of Repayment Date

Governor's Budget Request: The Governor's May Revision includes a request for a one-year extension to repay a loan from the Real Estate Appraisers Fund to the General Fund.

Background: The 2008 Budget Act authorized an $11.6 million loan from the Real Estate Appraisers Fund to the GF. The Administration requests that repayment of the loan be extended until Fiscal Year 2013-14. According to the January budget, the fund has a $2.4 million projected balance for 2012-13 after $5.1 million in projected expenditures.

Staff Recommendation: Adopt the proposed Budget Bill Language.

0820/1700/2240 DEPARTMENT OF JUSTICE/DEPARTMENT OF FAIR EMPLOYMENT AND HOUSING AND DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

Issue 1 – National Mortgage Settlement Proceeds

Governor's Budget Request: The Governor's May Revise includes a request via trailer bill language that identifies where a portion of the $410.6 million in discretionary funds will be spent in Budget Year 2012-13. According to the proposed trailer bill, for 2011-12 and 2012-13, $94.2 million of the settlement will be utilized to offset General Fund contributions that support public protection, consumer fraud enforcement and litigation, and housing related programs. Specifically, the funds will be utilized for the following programs in 2012-13:

- $41.1 million paid as a civil penalty into the Unfair Competition Law Fund to offset the costs of the various Department of Justice Programs.
- $44.9 million to support the Department of Justice's Public Rights and Law Enforcement programs relating to public protection and consumer fraud enforcement and litigation.
- $8.2 million for the Department of Fair Employment and Housing. This will offset a portion of the General Fund contribution made to the Department; the contribution from this settlement reflects the housing related portion of the Department's workload.
- $198 million will be set aside to offset General Fund costs for housing bond debt service for those programs funded with Proposition 46 and Proposition 1C housing bonds that assist homeowners.

The remaining funds ($118.4 million) will be set aside for use in the 2013-14 budget for similar purposes.

Background: On February 9, 2012, the federal government and 49 states reached a settlement with a number of national banks with respect to certain practices implemented by these banks regarding mortgage servicing and home foreclosures, the agreement was signed off by a federal judge on April 6th. The settlement provides for relief for borrowers in the form of modifications, mortgage loan servicing reforms, increased compliance monitoring and enforcement. In joining the national servicing settlement agreement the state was able to reach an agreement that could amount to $18 billion in support for homeowners in the state. According to the Department of Justice, the settlement will be structured as follows:

- $12 billion will be dedicated to reduce the principal balance on loans by offering either affordable modifications or short sales to approximately 250,000 California homeowners.
- $430 million payment in penalties, costs, and fees.
- $849 million to help refinance the loans of approximately 28,000 California homeowners with interest rates above 5.25 percent who are current on their mortgage payments but underwater on their loans.
- $279 million will be dedicated to provide payments to approximately 140,000 homeowners foreclosed upon during the worst period of servicing misconduct.
- $1.1 billion will be distributed to California communities to repair blight and devastation left by waves of foreclosures in hard-hit areas.
- $3.5 billion to forgive unpaid debts to banks for about 32,100 homeowners who have lost their homes to foreclosure.

LAO Findings: It is the LAO's belief the administration's proposal to use the settlement proceeds to provide budgetary savings makes sense given the state's fiscal situation. However, some of the expenditures that the administration proposes to offset with the settlement proceeds may fall outside the intent of the settlement agreement to the extent that they do not directly relate to consumer fraud, borrower relief, services for homeowners, or other specified uses. For example, the administration proposes to fully supplant General Fund support for DOJ's Division of Law Enforcement, which conducts investigations into organized crime, gangs, and drug trafficking. This may expose the state to legal challenges.

However, while the administration takes a cautious approach by limiting the expenditure of settlement funds to homeowner programs as prescribed by the agreement, we believe the Legislature is not legally restricted from appropriating these funds for other purposes. The settlement provides damages that were awarded directly to the state and that are not being held in trust for particular individuals. Therefore, the terms of the settlement agreement do not limit the Legislature's appropriation authority. Consequently, we believe the full amount of the state's settlement is available for appropriation in the current and budget years to cover costs not contemplated by the settlement agreement.

LAO Recommendation: Modify the Governor's proposal to use the full $411 million settlement to offset General Fund costs in the current and budget years, rather than reserving $118 million to offset costs in 2013-14.

Staff Comment: According to the actual settlement terms the state does seem to have the capacity to use the funds as specified. However, it is important that the settlement be viewed

strictly through the terms agreed to by the state and not through the prism of what agreements were reached with other states.

"The payment to the California Attorney General's Office shall be used as follows: a) Ten percent of the payment shall be paid as a civil penalty and deposited in the Unfair Competition Law Fund; b) The remainder shall be paid and deposited into a Special Deposit Fund created for the following purposes: for the administration of the terms of this Consent Judgment; monitoring compliance with the terms of this Consent Judgment and enforcing the terms of this Consent Judgment; assisting in the implementation of the relief programs and servicing standards as described in this Consent Judgment; supporting the Attorney General's continuing investigation into misconduct in the origination, servicing, and securitization of residential mortgage loans; to fund consumer fraud education, investigation, enforcement operations, litigation, public protection and/or local consumer aid; to provide borrower relief; to fund grant programs to assist housing counselors or other legal aid agencies that represent homeowners, former homeowners, or renters in housing-related matters; to fund other matters, including grant programs, for the benefit of California homeowners affected by the mortgage/foreclosure crisis; or to engage and pay for third parties to develop or administer any of the programs or efforts described above."

Staff Recommendation: Leave this item open.

1110 STATE CONSUMER SERVICES AGENCY

Issue 1 – Implementation of Business and Professions Code Section 35 Supplemental Reporting Language

Background: According to AB 2783, Statutes of 2010, Chapter 214, the Legislature determined that the California Military Department shall be consulted before the adopting of rules and regulations that provide for the licensure and regulation of certain businesses, occupations, and professions by specified boards within the Department of Consumer Affairs created under the Business and Professions Code. Specifically, the section states:

"It is the policy of this state that, consistent with the provision of high-quality services, persons with skills, knowledge, and experience obtained in the armed services of the United States should be permitted to apply this learning and contribute to the employment needs of the state at the maximum level of responsibility and skill for which they are qualified. To this end, rules and regulations of boards provided for in this code shall provide for methods of evaluating education, training, and experience obtained in the armed services, if applicable to the requirements of the business, occupation, or profession regulated. These rules and regulations shall also specify how this education, training, and experience may be used to meet the licensure requirements for the particular business, occupation, or profession regulated. Each board shall consult with the Department of Veterans Affairs and the Military Department before adopting these rules and regulations. Each board shall perform the duties required by this section within existing budgetary resources of the agency within which the board operates."

Staff Comment: To date, it seems that a limited amount of consultation has occurred. The Assembly has taken action to include Supplemental Reporting Language asking that:

"*The Department of Consumer Affairs shall prepare a report describing its implementation of Business and Professions Code Section 35. No later than October 1, 2012, the department shall report to the Subcommittee the following:*

1. *A list of the boards that have statutes, rules, regulations or agreements allowing military experience to be used to meet professional licensure requirements and a description of the statutes, rules, regulations, or agreements.*

2. *A list of the boards that do not have statutes, rules, regulations or agreements allowing military experience to be used to meet professional licensure requirements with an explanation from the boards on why they do not have statutes, rules, regulations or agreements.*

3. *If the board has decided not to accept military experience, an explanation from the board about why they do not accept military experience.*

4. *A description of the department's actions to direct the boards to implement this code section, including any memoranda to boards or other evidence of the department's actions.*

5. *A description of how the department has interacted with the Department of Veterans Affairs and the Military Department regarding this issue."*

Staff would recommend that the Senate Budget and Fiscal Review Subcommittee No. 4 adopt a similar recommendation to include the Supplemental Reporting Language mentioned above.

Staff Recommendation: Adopt Supplemental Reporting Language referenced above.

8940 CALIFORNIA MILITARY DEPARTMENT

Issue 1 – State Active Duty Compensation

Background: The Senate Budget and Fiscal Review Subcommittee heard the Governor's 2012-13 budget request to add $1.147 million ($495,000 GF) to support state active duty personnel cost increases that stem from increases approved by Congress on March 15th. The Assembly heard the item shortly thereafter, and, included Budget Bill Language asking the Military Department to review all existing State Active Duty positions to determine which could be converted to State Civil Service upon becoming vacant to the Legislature no later than December 31, 2012.

Staff Comment: In accordance with Sections 320 and 321 of the Military and Veterans Code, pay for State Active Duty employees is based upon federal military pay scales that are determined by Congress. Compensation is based on each military member's pay grade, duty location, and years of military service. The table below represents the cost of the position slotted for State Active versus a similar position within the State Civil Service classification:

Positions Slotted to Convert to SCS

SAD Position	Base Pay+BAH=Salary	SCS Classification	Salary Range
Position Control NCO (E7)	$6687	AGPA	$4400 - $5348
Chief HRO (W4), SP,	$9268	SSM II	$6173 - $6727
Fiscal NCO (E7), Sunburst	$7203	Associate Budget Analyst	$4400 - $5350
Security Forces Admin NCO	$5317	Executive Secretary	$3020 - $3672
Youth Programs Admin NCO	$5317	Executive Secretary	$3020 - $3672
Real Property Tech	$5317	Associate Budget Analyst	$4400 - $5348
Federal Government Liaison	$8493	CEA I	$6173 - $7838

Staff Recommendation: Adopt Budget Bill Language asking the Military Department to review all existing State Active Duty positions to determine which could be converted to State Civil Service upon becoming vacant and report their findings to the Legislature no later than December 31, 2012.

1690 SEISMIC SAFETY COMMISSION

Governor's Budget Request: The Governor's May Revise includes a request via trailer bill language to establish the Seismic Safety Account within the Insurance Fund. The Seismic Safety Account would then be utilized, at the discretion of the Legislature, to fund Seismic Safety Commission related activities.

The Governor's January 2012-13 Budget included a request to fund the Seismic Safety Commission with direct support from the Insurance Fund.

Background: The Seismic Safety Commission was originally created in 1975 and was supported by the General Fund. The Commission's mission is to investigate earthquakes, research earthquake related activities and recommend to the Governor and the Legislature policies and programs needed to reduce earthquake risk. Additionally, the Commission is responsible for managing *California's Earthquake Loss Reduction Plan 2007-2011.*

The Commission currently has one office that houses 6.4 positions and supports the Commission's activities including the bi-monthly meetings at various sites statewide. The use of the Insurance Fund for the Commission was designed to be a short term solution. However, the ongoing budget concerns in the state have forced the Commission to utilize the Insurance Fund as a more permanent source of funding.

Staff Comment: When reviewing the January submission to re-approve the use of the Insurance Fund as a funding source it was brought to the Legislature's attention that use of the Insurance Fund as originally structured by the Commission would be unconstitutional. Specifically, Article XIII, Section 28 (f) of the California Constitution specifies that, with limited exceptions, the state's insurance tax shall be in lieu of all other state and local taxes. This seismic safety assessment imposed on the gross receipts of insurers of commercial and residential properties is a tax under the provisions of Proposition 26.

The Commission, with technical assistance from the Department of Finance, has submitted a revision to their original request that would have the Department of Insurance calculate an annual assessment not to exceed $0.15 on commercial and residential property policy holders to be collected by insurers. According to Legislative Counsel the proposed trailer bill language does not raise the constitutional concerns referenced above but, in accordance with Proposition 26, is subject to a supermajority vote.

Staff Recommendation: Hold open, item included for discussion.

0860 BOARD OF EQUALIZATION

Issue 1 – Dell Computer Settlement

Background: The BOE was named as the cross defendant in the class action case of *Diane Mohan v. Dell*, currently pending in San Francisco County Superior Court. The case involves the collection of use tax by Dell Computers on the extended warranty service contracts during the years 2000 to 2008. The extended warranty service contract is an intangible and the court found that the use tax was collected erroneously. The class action attorneys have estimated as many as 10 million transactions over this time period. The BOE's experience is that about 20 percent actually completed refund claims and submitted them for payment, but this could still mean hundreds of thousands of claims that need to be processed. The BOE has indicated that it does not have the staff to process these additional transactions.

Governor's Budget: The Governor's budget included a "placeholder" request of $3.2 million ($2.1 million General Fund) in the budget year to support 14.5 positions to address the additional workload associated with processing the Dell refunds. The majority of these positions are proposed as limited-term, but the request does include two permanent positions. The positions are proposed to be allocated as follows:

- 2 tax auditors for 2-year limited-term to audit large and medium-sized refund claims.
- 1 business tax specialist for 2-year limited-term to audit largest and most complex claims.
- 1 business tax specialist for 1-year limited-term to coordinate, initiate, and review refund processing.
- 3 tax technician IIIs for 2-year limited-term to search for better addresses for returned warrants and respond to inquiries by class action administrator.
- 3.5 tax technician IIIs for 1-year limited-term to validate name/address changes and process correspondence related to claim exceptions.
- 1 supervising tax auditor II for 2-year limited-term to manage the overall refund project.
- 1 associate accounting analyst permanently established to review refunds and reconcile claims filed and claims paid.
- 1 associate administration analyst permanently established to maintain claim databases.
- 1 tax technician II for 2-year limited-term to manage 30,000 additional calls in the call center expected from the class action lawsuit.

Further Information: This item was heard by the Subcommittee at its May 3rd Hearing and held open. In the subcommittee hearing questions arose regarding the status of the Dell Settlement and the need for the positions noted. BOE now has a signed settlement agreement and expects expenditures in FY 2012-13 and FY 2013-14. The potential refunds range from $50 to $250 million. It is estimating the total number of refund claims to be approximately 2 million or 20 percent of the 10 million original transactions where sales tax was charged on the extended warranty contract.

Key dates outlined in the attached settlement agreement include:

- April 30, 2012 - Dell to provide the BOE a payables database, which contains the total potential number and amount of claims. (BOE received a disk from Dell on May 2, 2012 and is currently in the process of importing or uploading the data of the universe of claimants.)

- Before July 16, 2012 – Notices will be mailed to Dell customers. The website will also go live.
- Customers will have until mid-September 2012 to opt out of the class action lawsuit.
- The customers may file claims through January 16, 2013.
- BOE will pay claims for refunds in batches as they come into BOE.
- BOE anticipates paying claims in FY 2012-13 and FY 2013-14. Approximately 751 audits of refund claims are expected. Materiality thresholds will be established and all claims over a certain dollar threshold will be audited. Remaining claims will be selected on a random sample basis.
- Staffing levels of 14.5 positions in FY 2012-13 dropping to 10.0 positions for FY 2013-14 to validate, audit and process claims for refund, look for refund offsets to other agencies, address returned warrants, perform account maintenance, reconcile claims filed and paid, provide proper documentation to the State Controller's office, and answer telephone inquiries related to the settlement and claim forms.

Staff Comments: The BOE has indicated that there is a signed settlement agreement in the Dell Computers case. Errors in the original BCP have been corrected to make all positions limited-term. The BOE has indicated that notices will be mailed to Dell customers by July 16, 2012 and that customers will have until mid-September 2012 to opt out of the class action lawsuit. The customers will be able to file claims through January 16, 2013. The BOE estimates that the majority of the claims will be paid in 2012-13. Assembly Budget Subcommittee 4 approved this request based on two-year, limited-term positions.

Staff Recommendation: Staff recommends that the Subcommittee approve this request on a two-year, limited-term basis, thus conforming to the Assembly action.

Vote:

Issue 2 – State Responsibility Area Fire Prevention Fee Collection

Background: Last year, Chapter 8x, Statutes of 2011 (AB 29x, Budget) was enacted to implement a fire prevention fee on owners of habitable structures in state responsibility areas (SRAs). This legislation requires a fee of $150 per structure to support the fire prevention activities of the California Department of Forestry and Fire Protection. The BOE is assigned the responsibility of collecting the fee. The fee is expected to generate $50 million in the current fiscal year and $85 million in the budget year. This issue was heard on May 3, and held open.

Governor's Budget: The Governor's budget includes $6.4 million in reimbursements and 57 positions in the budget year to administer this program.

Staff Comments: Staff finds that the legislation enacted last year requires the California Department of Forestry and Fire Protection to submit to BOE a list of names and addresses of those that are required to pay the fee. Therefore, it is unclear why BOE requires the number of permanent staff being requested. It is expected that there would be startup costs associated with implementing a new fee collection program like the SRA fee. However, the BOE's proposal does not reflect much of a decline in ongoing resources needed to support this program. Staff notes that the Assembly Budget Subcommittee 4 has already taken action on this item and approved the staffing package on a two-year limited-term basis and also approved reporting

language to get more information on actual experience related to collecting the SRA fee.

Staff Recommendation: Staff recommends approving the request as two-year, limited-term positions and reporting language based on a full year of operation, thus conforming to the Assembly action.

Vote:

Issue 3 – AB 155 Use Tax Enforcement

Background: The Legislature passed, and the Governor signed, as part of the 2011-12 budget, AB 28 X1 (Blumenfield), Chapter 7, Statutes of 2011, which required that out-of-state businesses with certain connections to California—such as sales using affiliates or the presence in the state of related companies—be required to collect the use tax on behalf of the state. Subsequently, the operative date of this bill was delayed until fiscal year 2012-13 through the passage of AB 155 (Charles Calderon and Skinner), Chapter 313, Statutes of 2011, with the date of implementation dependent on the outcome of certain federal actions.

Budget Proposal: The budget proposes additional resources of $3.2 million ($2.1 million General Fund and $1.1 million special funds) and 28 positions to implement the expanded collection of the use tax by out-of-state business pursuant to AB 155. These additional resources will be used to identify out-of-state business required to collect the use tax and institute compliance programs for the initiative. Two positions relate to coordination of legislation that may be adopted at the federal level that could affect the implementation of the measure. The committee heard this item at its May 3 hearing and approved the proposal as budgeted; the item is being heard again for reconsideration.

Assembly Action: Assembly Budget Subcommittee 4 heard this issue at its May 9 hearing and approved the proposal with some revisions. All positions were approved on a two-year, limited-term basis, with the two legislative positions referenced-above to begin January 1, 2013.

Staff Comment: The approach taken by the Assembly Budget Subcommittee 4 is a reasonable one and would allow the Legislature to revisit this issue in a timely fashion when the program has been established. The issue was heard by the Subcommittee at a prior hearing and approved. It is being reopened for the purpose of making the positions limited-term as opposed to permanent.

State Recommendation: Rescind prior action on this budget item. Approve as two-year, limited term positions, thus conforming to Assembly action.

Vote:

Issue 4 – Centralized Revenue Opportunity System (CROS)

May Revision Proposal: As part of the May Revision, the Administration is requesting $23.8 million ($14.6 million General Fund) and 156.7 positions in 2012-13 and $29.1 million $18.1

million General Fund) and 242.1 positions in 2013-14 for the beginning stages of a new centralized data and tax collection system. The initial stage of the project would largely address the beginning implementation stage of the project, maintain the existing legacy systems, address data conversion issues, address external interface issues and engage in certain tax compliance and enforcement activities. While the initial phase of the project relates to preparatory work, the final product will result in combining several of the department's existing systems and provide a centralized and unified tax collection and data system. The project is designed to generate revenue during its implementation and will be structured based on "alternative procurement" in that it will be benefits-funded. During the initial two years, the project would result in additional revenue of $38.8 million in 2012-13 and $66.5 million in 2013-14.

Background: BOE's current automation systems were developed in the 1990s. The hardware and software which supports these systems is dated and more costly to maintain than newer technologies. Additionally, because BOE's systems have required continuous modifications over the last ten years, there has also been a significant, and steady, increase to the costs, staffing resources and time involved to make changes, enhancements, or maintain these systems. The programming language is outdated and it is becoming increasingly difficult to find staff, or contractors, to maintain the systems. The current systems are antiquated, do not have the capability to easily adapt to new or expanding requirements, and cannot adapt or take advantage of emerging technologies.

As the systems have become more dated, workload has increased. Over the recent past, BOE has been directed to implement several new tax and fee programs or other proposed statutory changes. Each of these statutory changes or new programs requires significant programming hours to modify the existing automation systems. Any new implemented tax program uses the same computer components as the existing tax programs while in use by BOE's multiple tax programs. Multiple programming changes are difficult to accomplish since programming components are tightly integrated and changes to the components disrupt existing tax program activities. Implementing a new tax and fee programs can take as long as ten months to complete with existing systems. In addition, the department is increasingly experiencing frequent and recurring requests for statistical data or quantitative information.

BOE has developed a number of ad hoc methods and ancillary systems to respond to these information requests. Extracts from the department's principal systems--Integrated Revenue Information System (IRIS) and Automated Compliance Management System (ACMS) are stored with data received from external agencies in data marts and reports are created utilizing desktop applications. The difficulty in accessing BOE internal data and the ability to only perform one-source data matching is cumbersome and often detrimental in responding timely to requests and performing program analysis. Requests still require programming expertise and are expensive and time consuming to perform. BOE does not have the business intelligence tools required to provide the requestor or client access to the information that is required to complete necessary business processes in a timely and cost effective manner.

To address this, BOE proposes a significant automation project which will ultimately replace IRIS and ACMS, its two current automation systems. In addition, the project will expand online taxpayer services and provide an enterprise data warehouse. This project will impact virtually all processing areas within the organization. The new technologies and tools will provide increased efficiency and will augment revenue production while incorporating "best practices" to reengineer how work is performed. Replacement of the legacy systems should improve the BOE's performance. Additionally, the integration of a data warehouse would provide a single

enterprise repository of BOE internal data and external data.

Proposal Detail: For the budget year 2012-13, roughly $12.3 million will constitute personnel services with the balance ($11.5 million) used for operating expenses and equipment (OE&E). A large portion of the OE&E—slightly less than $5 million—is for consulting services and data center services. About a third of the personnel will be directly involved in the CROS project, which in this phase is concentrated on project direction and generally relate to data cleansing and preparing for conversion to the new system. The positions, in addition to administrative project-direction positions--include software specialists, programmers, and system analysts. Performing much of this work in-house, as opposed to by the vendor--is expected to reduce overall project costs.

At the same time the activities related to the implementation of the CROS are occurring, other personnel will be addressing the accumulated backlog of activities that need to be addressed in preparation for the new integrated system. Significant backlogs have been identified in the areas of audits, collections, State wide Compliance and Outreach Program (a BOE tax gap program), offers in compromise, and settlements. Addressing the backlogs in these areas generates the revenues identified in the proposal. In addition, addressing the backlogs also makes the project itself more feasible by improving the quality of the data prior to system implementation.

Subsequent Proposal Revision: Staff requested the department reformulate its proposal to postpone certain CROS components while maintaining the revenue generated in the budget year as well as the overall implementation of the project. BOE staff responded with a recalibrated BCP that lowers costs in 2012-13. BOE identified 43.7 positions that may be delayed starting until 2013-14. A majority of these positions are under the CROS proper component. The department indicates that it can delay the starting date for certain specialized staff until the second year and still achieve the desired revenue of $38.8 million in 2012-13 and $66.5 million in 2013-14. This proposed reduction represents a 28 percent reduction from the original position request. With this reduction, BOE would be requesting 113.0 positions and $18.1 million ($11.2 General Fund) in 2012/13 and 242.1 positions and $30.1 million ($18.7 General Fund) in FY 2013-14.

Questions:

BOE: Can you outline the timing for the implementation of the project?

BOE: How will you proceed on the benefits-funded approach for the project?

BOE: Could you address the impact of simply going forward with the revenue related positions without the CROS-related positions?

LAO: Does the approach of the department resemble the approach taken in other benefits-funded projects?

CTA: Could you comment on the outline of the proposal and the procurement approach?

Staff Comments: The department's current proposal is much improved from earlier draft versions. Technology and data system improvements at BOE are overdue. Its technology systems are clearly dated and expensive, and the current proposal is a reasonable start in the process of modernization. The department has pursued a benefits-funded approach that has

been recommended in the past and has also reviewed the plan with other agencies in order to benefit from lessons learned. In particular, the department has consulted with the Franchise Tax Board, which has been generally successful with its various technology modernization projects. The short-term benefit/cost ratio does not meet historical standards, but the project is based not on short-term returns, but rather longer-term benefits. In addition, the benefit/cost ratio is generally in keeping with FTB's similar technology upgrades. An interim report for this project that would allow the Legislature to evaluate progress in conjunction with subsequent budget requests the department indicates will be forthcoming. The proposal may also benefit from additional vetting of the estimated revenue generated by the project. This could be incorporated as part of the reporting language. Finally, the proposal as adjusted would maintain revenues while reducing costs for the project.

Staff Recommendation: Approve project funding based on the revised BCP from the department with SRL requiring a status report to the Legislature after the initial full year of implementation.

Vote:

8885 COMMISSION ON STATE MANDATES (COSM)

Background: The Governor's Budget proposes the continued funding of property tax and public safety mandates, discussed in Issue 1 below. In addition, the Governor's Budget achieves substantial savings by the continued suspension (and in some cases, repeal) of various mandates that are not associated with law enforcement or property taxes as discussed in Issue 2 below. Of the $4.2 billion in expenditure reductions identified as budget balancing solutions, cost reductions related to mandates account for $828 million. This $828 million is comprised of the following:

- **Suspended Mandates.** 56 mandates are slated for suspension, resulting in a savings in the budget year of $375.7 million.

- **Expired Mandates.** 10 expired mandates will not be funded in the budget plan, resulting in a savings of $295.1 million.

- **Deferred Payment Mandates.** 2 mandates noted above are still in place but the payment has been deferred, resulting in a savings of $57.9 million.

- **Pre-2004 Mandates.** Payment for mandate costs incurred prior to 2004 is deferred resulting in a budget year savings of $99.5 million. These costs must eventually be paid by 2021.

Once a required activity or expanded activity imposed on local governments has been determined to be a mandate, the State still has some options regarding the actual funding of this mandate.

- **Fund the Mandate.** If the State chooses to fund the mandate, it is required to pay for all unpaid bills submitted since 2003 up through the most current year of cost approval.
- **Suspend the Mandate.** Suspension of a mandate through the budget process keeps the mandate on the books, but absolves the local government of responsibility of providing the service and relieves the State of paying the cost of the service during the suspension.

Proposition 1A, adopted by the voters in 2004, requires the Legislature to either fund mandates and appropriate funds for payment, or suspend or repeal the mandate. Two mandates were exempt from this requirement, allowing them to remain in place even without funding. These two mandates are Peace Officer Procedural Bill of Rights (POBAR) and Local Government Employee Relations mandate. These mandates have continued and reimbursable costs due local governments are continuing to accrue. Proposition 1A also requires the Legislature to pay all pre-2004 mandate claims over a period of time. The State owes local agencies in excess of $1 billion in unpaid mandate costs. A portion of these costs is scheduled to be paid by 2021, while other costs have no payment schedule in place.

In the recent decades, the Legislature has suspended numerous mandates as a form of budget relief. In the current year, some 60 mandates have been suspended. A large number of the suspensions occurred during the current period of budget difficulties, although some suspensions go back to 1990. Some have been suspended immediately after COSM reported their costs to the Legislature.

Issue 1 – Funded Mandates

Governor's Budget Request: The Governor's proposal includes the continued funding of certain mandates related to public safety and property taxes. The policy reason behind the decision to fund the public safety mandates is apparent given the focus of these requirements. For property tax-related mandates, the policy motivation for funding these is based on the statewide interest in property tax compliance, given the interrelationship of education funding from local property taxes and General Fund obligation to backfill education costs for purposes of the Prop 98 guarantee. In addition to the General Fund cost presented in the table below, the request includes an additional $2.5 million from special funds.

Proposed Funded Mandates

Mandate	2012-13 GF Cost ($000s)
Threats Against Peace Officers	26
Custody of Minors: Child Abduction and Recovery	12,999
Medi-Cal Beneficiary Death Notices	10
Sexually Violent Predators	20,963
Domestic Violence Treatment Services	1,944
Domestic Violence Arrest Policies	7,608
Unitary Countywide Tax Rates	267
Allocation of Property Tax Revenues	727
Rape Victim Counseling	349
Health Benefits for Survivors of Peace Officers and Firefighters	1,695
Crime Victims' Domestic Violence Incident Reports	167
Peace Officer Personnel Records: Unfounded Complaints & Discovery	657
Domestic Violence Arrests and Victims Assistance	1,374
Total Funded Costs	**48,786**

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

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

Vote:

Issue 2 – Suspended Mandates

Governor's Budget Request: The mandates slated for suspension under the Governor's proposal are listed in the table below. Many of these have been suspended for several years, usually as part of the budget process. In general, the suspension of many of the mandates has not been subject to a thorough policy review that would result in an evaluation of the costs and benefits of the mandate, but rather have been suspended solely for the purpose of budgetary savings. The policy decision to establish the mandate in the first place has not generally been a substantial component of the discussion.

In addition to the suspension, the Administration has proposed trailer bill language (TBL) that certain mandates be repealed. These are denoted by an asterisk in the list below. The budget year savings associated with suspension and repeal are identical. With suspension, the mandate remains in statute but is simply not funded. As a result, in order to determine whether a mandate is actually in effect, confirmation of both the statutory reference and the budget bill is required. With repeal, the statute requirement is repealed by Legislative action.

Suspended Mandates

Mandate	2012-13 GF Savings ($000s)
Adult Felony Restitution*	0
AIDS/Search Warrant*	1,596
Airport Land Use Commission/Plans*	1,595
Animal Adoption*	46,296
Conservatorship: Developmentally Disabled Adults*	349
Coroners' Costs	222
Crime Victims' Domestic Violence Incident Reports II*	1,959
Deaf Teletype Equipment*	0
Developmentally Disabled Attorneys' Services	1,198
DNA Database & Amendments to Postmortem Examinations: Unidentified Bodies	310
Domestic Violence Information*	0
Elder Abuse, Law Enforcement Training*	0
Extended Commitment, Youth Authority*	0
False Reports of Police Misconduct*	10
Filipino Employee Surveys*	0
Firearm Hearings for Discharged Inpatients*	157
Grand Jury Proceedings*	0
Handicapped Voter Access Information	0
Inmate AIDS Testing*	0
Judiciary Proceedings*	274
Law Enforcement Sexual Harassment Training*	0
Local Coastal Plans*	0

Mandate	2012-13 GF Savings ($000s)
Mandate Reimbursement Process	6,419
Mandate Reimbursement Process II (includes suspension of consolidation of the two)	0
Mentally Disordered Offenders: Treatment as a Condition of Parole	4,910
Mentally Disordered Offenders: Extended Commitments Proceedings	7,232
Mentally Disordered Sex Offenders: Recommitments	340
Mentally Retarded Defendants Representation*	36
Missing Persons Report*	0
Not Guilty by Reason of Insanity*	5,214
Open Meetings Act/Brown Act Reform	96,090
Pacific Beach Safety: Water Quality and Closures	344
Perinatal Services*	2,338
Personal Safety Alarm Devices*	0
Photographic Record of Evidence*	291
Pocket Masks*	0
Post-Conviction: DNA Court Proceedings	410
Postmortem Examinations: Unidentified Bodies and Human Remains	1,180
Prisoner Parental Rights*	0
Senior Citizens Property Tax Postponement	481
Sex Crime Confidentiality	0
Sex Offenders: Disclosure by Law Enforcement Officers	0
SIDS Autopsies*	0
SIDS Contacts by Local Health Officers*	0
SIDS Training for Firefighters*	0
Stolen Vehicle Notification*	1,117
Very High Fire Hazard Severity Zones	0
Victims' Statements-Minors*	0
Fifteen-Day Close of Voter Registration	0
Absentee Ballots	50,924
Permanent Absent Voters	2,686
Absentee Ballots-Tabulation by Precinct	68
Brendon Maguire Act	0
Voter Registration Procedures	2,452
In-Home Supportive Services II	449
Crime Statistics Reports for the DOJ and CSR for the DOJ Amended*	138,722
Total Suspended Savings	**$375,669**

The 56 mandates proposed to be suspended for 2012-13 generally include the same mandates that were suspended last year. In addition, some mandates suspended during the current year have expired. The suspension of these mandates would result in budget savings of almost $376 million.

Actions in Other Subcommittees: The Senate Budget Committee adopted a process to allow examination of mandates selected for repeal by its appropriate subcommittees. The following actions have been taken in those subcommittees:

- **Suspensions.** At its May 10 hearing, Senate Budget Sub 5 approved the suspension of all public safety mandates noted in the table above, except for one mandate. (This remaining mandate relates to Crime Statistics Reports, and will also be addressed in Subcommittee 5.)

- **Reject Repeal TBL.** At its April 11 hearing, Senate Budget Sub 2 rejected the TBL to repeal the mandates for Airport Land Use Commission/Plans, Animal Adoption, Local Coastal Plans and SIDS Training for Firefighters. At its May 10 hearing, Senate Budget Sub 3 took action to reject TBL to repeal the mandates for Conservatorship for Developmentally Disabled Adults, and at its March 8 hearing rejected the TBL to repeal SIDS Autopsies, and SIDS Contacts by Local Health Officers.

- **Adopt Repeal TBL.** At its May 8 hearing, Senate Budget Sub 5 took action to approve TBL to repeal the mandate for Filipino Employee Surveys. At its March 8 hearing, Senate Budget Sub 3 took action to approve TBL to repeal the Perinatal Services.

Assembly Actions: Assembly Budget Subcommittee 4 considered mandates at its March 13 hearing. It took action to suspend those mandates noted in the table above, but reject the repeal TBL in its entirety. (It also approved funding the mandates noted in Issue 1, above.)

Staff Comment: At the time this agenda was finalized, no concerns had been raised with the continued suspension of these mandates. The mandates selected have been suspended in previous years. Regarding the TBL to repeal, a careful review should be conducted. Some of the mandates were considered as part of the budget subcommittee process and actions taken. To the extent that this did not occur, these proposals should be referred to policy committee that considers and addresses the particular subject matter.

Staff Recommendations: Suspend mandates proposed by the Governor for suspension, as noted above. Reject TBL to repeal selected mandates, except for those two mandates noted above where repeal TBL was specifically approved in subcommittee.

Vote:

9210 LOCAL GOVERNMENT FINANCING

Department Overview: The 9210 budget item includes several programs that make State subventions to local governments. The payments include $2.1 billion General Fund for constitutionally-required repayment of 2009-10 "Prop 1A" borrowing from local governments; a small subvention related to former Redevelopment Agencies (RDAs) to help retire a portion of outstanding debt that was backed by the personal property tax – about $500,000, and a new subvention of $4.4 million General Fund proposed this year for Mono and Amador counties.

Budget Overview: The proposed budget for the 9210 item is $2.1 billion General Fund. Year-over-year comparisons show a major increase in expenditures as Prop 1A borrowing was $91 million in 2011-12 and will be $2.1 billion in 2012-13. Prop 1A debt will fully be repaid in 2012-13, so there is no ongoing cost. Additionally, some public safety grants were included in this item in prior years, but that funding was shifted with the 2011 Public Safety Realignment legislation and is now funded with the new local revenues instead of State grants.

Issue 1 – Reimbursements to Amador County

Governor's Request: In the January Budget, the Governor proposed a new General Fund subvention of $4.4 million to backfill Mono and Amador counties due to unique circumstances that reduced property tax directed to those county governments and cities within those counties in 2010-11. In an April 1 Finance Letter, the Governor rescinded the funding for Mono County indicating that updated data suggested the problem did not exist in that county for 2010-11. The Governor maintains the funding request of $1.5 million for Amador County. The revenue loss is understood to also have occurred in 2011-12 and will continue into 2012-13 and likely beyond, but the Administration indicates it is undetermined at this time whether its proposal is one-time or ongoing.

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

- **Financing Economic Recovery Bonds (ERBs).** In the 2004 primary election, voters approved Proposition 58, which allowed the State to sell ERBs to pay its accumulated budget deficit. The local sales tax for cities and counties was reduced by one-quarter cent and the State sales tax was increased by one-quarter cent to create a dedicated funding source to repay the ERBs. Property tax was redirected from schools to cities and counties, and the State backfilled schools via the Proposition 98 funding guarantee. This financing mechanism is sometimes called the "triple flip," and was anticipated to hold local governments harmless. When the ERBs are repaid in 2016-17 (or earlier), the local sales tax rate is restored.

- **Backfilling for the Vehicle License Fee (VLF) Tax Cut**. Also in 2004, the Legislature enacted the "VLF Swap" to provide a more reliable funding mechanism to backfill cities

and counties for the local revenue cut by the State when the VLF tax on motor vehicles was reduced from 2.0 percent of a vehicle's value to 0.65 percent of a vehicle's value. Here again, the state redirected property tax from schools to cities and counties and backfilled schools with State funds.

- **Problem for Amador**: The funding mechanism stopped fully working for Amador County (and initially Mono County) reportedly in 2010-11 due to all the schools in those counties becoming "basic aid" schools. Basic aid schools receive sufficient local property tax to fully fund the per-student amounts required by the Proposition 98 guarantee and therefore the State's funding is minimal. Due to this "basic aid" situation, current law would not backfill schools for any property tax shifted to cities and counties and county auditors have reportedly reduced or discontinued the "AB 8" shift of property tax from schools to those cities and counties. The estimated loss for the two counties in 2010-11 is $4.4 million. Conversely, in a non-"Test 1" Proposition 98 year, the State would realize a savings from not having to backfill schools – but 2012-13 appears to be a Test 1 year.

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

- **Revenue growth uncertainty.** The funding shifts did include uncertainty and risk, as the relative growth of various revenue streams over many years was unknown. On a statewide basis, data suggests most counties – perhaps as many as 56 of 58 counties - have received a net benefit from the shifts. Since 2010-11, reportedly Amador has not seen net benefits. Individual county estimates of benefits or costs are not currently available, but Amador County has estimated the isolated effect of the property tax shift at $1.5 million.

- **No backfill guaranteed in the original legislation, but the Amador outcome was not anticipated.** The enacting legislation did not include provisions for the State to backfill locals with new subventions if the baseline funding mechanism proved to be insufficient to maintain city and county funds. At the time of the legislation, stakeholders were likely aware of the risk of variable levels of growth for different revenue streams, but may not have anticipated this outcome of all schools within the county becoming "basic aid." Since this outcome may not have been foreseen by the State or local governments at the time of bill enactment, does the State have a responsibility to backfill for this revenue loss?

- **Budget challenges in most cities and counties.** Since many cities and counties are continuing to experience budget shortfalls, should the Legislature consider the fiscal condition of the two counties relative to other counties as a factor in the determination. For example, has the decline in revenue for these counties since 2007-08 exceeded the statewide average?

- **Timing of the Subvention.** If the Legislature determines a subvention is appropriate, should the Legislature appropriate for revenue loss through 2012-13 (maybe funding at a level of $13.2 million), or conversely decide to fund, but defer reimbursement to later in the fiscal year.

Question:

LAO: Is there any potential for other counties to fall into a position similar to Amador's? What might be the potential costs to the state?

Staff Comment: The Subcommittee heard this issue on March 8, when the Administration was requesting $4.4 million for Amador and Mono counties, and the issue was left open. The Administration has reduced the request in an April 1 Finance Letter and is currently requesting only $1.5 million for Amador County, indicating that Mono County did not lose funds in 2010-11.

Staff Recommendation: Staff recommends approving the budget request, with one-half the funding to be provided initially and the remainder to be disbursed upon a finding of necessity by the Department of Finance based on criteria established in Budget Bill Language. Absent a finding by Department of Finance, the funds would revert to the General Fund. Staff also recommends that LAO and DOF be directed to develop criteria whereby funding for such backfill shortfalls might be determined in the future.

Vote: