Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 4 Agenda

Senator Michael J. Rubio, Chair
Senator Noreen Evans
Senator Doug LaMalfa

Thursday, May 5, 2011
9:30 a.m. or Upon Adjournment of Session
Room 112

Consultants: Brian Annis, Keely Bosler,
Kris Kuzmich, and Seija Virtanen

JANUARY BUDGET REQUESTS DENIED WITHOUT PREJUDICE AND APRIL FINANCE LETTERS

OUTCOMES

DEPARTMENTS TO BE HEARD

(Please See Detailed Agenda on Pages 2 and 3 for More Specific Listing and Order of Departments and Issues to Be Heard)

0502	California Technology Agency
0520	Secretary of Business, Transportation, and Housing Agency
0840	State Controller's Office
0845	Department of Insurance
0890	Secretary of State's Office
0971	California Alternative Energy and Advanced Transportation Authority
1110	Department of Consumer Affairs
1730	Franchise Tax Board
2320	Department of Real Estate
8380	Department of Personnel Administration
8880	Financial Information System for California (FI$Cal)
8955	California Department of Veterans Affairs

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AGENDA – VOTE ONLY ITEMS

(Please see summary chart on Page 4)

AGENDA – DISCUSSION / VOTE ITEMS

Issues Proposed for Vote Only:

	Issue	Amount	Fund Source	Staff Recommendation
	Secretary of Business Transportation and Housing Agency (0520)			
1	Small Business Loan Guarantee Program Expansion	$84.4 million scheduled over three fiscal years.	Federal Funds	APPROVE, as specified
	State Controller's Office (0840)			
1	Increased Postage Expenses	$43,000 in 2010-11 $217,000 in 2011-12 and ongoing	Reimbursements	APPROVE
2	Transportation Audits Indirect Allocation Plans	$1,751,000 in 2011-12 and 12.6 two-year limited-term positions (Includes supplemental reporting language)	Reimbursements	APPROVE, as specified
	Department of Insurance (0845)			
1	Workers' Compensation Insurance Fraud Program: Local Assistance Workload Increases	$1,646,000 in 2011-12	Insurance Fund	APPROVE
	California Alternative Energy and Advanced Transportation Authority (0971)			
1	Energy Upgrade California Program	$205,000 in 2011-12	Reimbursements	APPROVE
	Department of Consumer Affairs (1110)			
1	Board of Professional Engineers and Land Surveyors Licensing Exams	$1,124,000 on a one-time basis	Special Funds	APPROVE
	Franchise Tax Board (1730)			
1	Data Security and Reliability: Enterprise Tape Library	Shift $2,290,000 from 2010-11 to 2011-12	General Fund	APPROVE
2	Voluntary Contribution Funding Codes: Budget Bill Clean-up	Language only	Language only	APPROVE
	Department of Real Estate (2320)			
1	SB 36 Mortgage Loan Originator Licensure (SAFE Act)	$216,000 in 2011-12 and 2 positions	Real Estate Fund	DENY
	Department of Personnel Administration (8380)			
1	Removal of Recruitment Contract Funding and Language	$350,000 in 2011-12 and modified budget bill language $350,000 in 2010-11 $350,000 in 2009-10	General Fund	APPROVE, as specified

Vote: Staff recommendation for all vote-only items adopted by 3-0 vote.

Issues Proposed for Vote Only – Issue Descriptions

SECRETARY OF BUSINESS, TRANSPORTATION, AND HOUSING AGENCY (0520)

Department Overview: The Secretary of the Business, Transportation and Housing Agency (BT&H Agency) is a member of the Governor's Cabinet and oversees 16 departments, including the following large departments:

- Alcoholic Beverage Control
- Corporations
- Housing and Community Development
- California Highway Patrol
- Motor Vehicles
- Financial Institutions
- Real Estate
- Managed Health Care
- Transportation

In addition, the Secretary's Office oversees programs, including the following, which are budgeted directly in the Secretary's Office:

- Infrastructure and Economic Development Bank
- Film Commission
- Small Business Loan Guarantee Program
- Tourism Commission

Budget Overview: The January Governor's Budget proposed total expenditures of $100.9 million ($4.2 million General Fund) and 60.7 positions for the Office of the Secretary – an increase of $78.2 million from the adjusted 2010-11 budget, and an increase of 1.5 funded positions. The primary reason for the year-over-year change is a one-time federal grant of $84.4 million to support the Small Business Loan Guarantee Program.

Current Budget Status: The Legislature made some modifications to the proposed budget for the Small Business Loan Guarantee Program, but otherwise approved the BT&H Agency budget as proposed. An April 1 Finance Letter was proposed to make some technical scheduling adjustments for federal grants to the Small Business Loan Guarantee Program which is discussed below as Issue 1.

Issue 1 –Small Business Loan Guarantee Program Expansion

April Letter Request. The Governor's April 1st Letter adjusts the budget to correctly reflect federal funds by year of receipt for the grants awarded to the Small Business Loan Guarantee Program. Instead of $84.4 million being received in 2011-12 (as was scheduled in the January Budget), the funds would be received as follows: $27.8 million in 2010-11, $27.8 million in 2011-12, and $28.7 million in 2012-13.

Background. The Governor's Budget requested various budget changes related to a federal grant award that will result in a one-time federal grant of $84.4 million for the Small Business Loan Guarantee Program (SBLG). This represents a significant expansion of the program which has typically had a trust-fund balance between $30 million and $40 million. The SBLG Program provides assistance to small businesses that may not qualify for traditional loans, by guaranteeing a portion of the loaned amount. The Administration requests to revert $20 million in General Fund support provided to the program one-time as part of the 2010 Budget Act (AB 1632, Chapter 731, Statutes of 2010). This reversion of $20 million is contingent on receipt of the federal funds. Finally, the Administration requests to double program staff from 1.5 positions to 3.0 positions.

Prior Subcommittee Action. The Subcommittee heard this item February 3 and February 10 and determined that the Federal grant will allow the State to expand this program, and at the same time realize a GF benefit of $20 million by reverting the augmentation provided last year. Specifically, the Subcommittee adopted the following:

a) The Governor's proposal to revert $20 million to the GF;
b) Budget Trailer Bill Language to direct that new loan guarantees use federal funds first;
c) Approved 0.5 new staff instead of 1.5 new staff;
d) Converted program administration funding to 50-percent GF and trust fund interest, and 50-percent federal funds, instead of eliminating all GF support for administration. This provided additional FDC administration funding over the base level for ramp-up, but still resulted in a GF expenditure savings; and,
e) Adopted provisional budget bill language to allow the Director of Finance to transfer up to $20 million from the GF to the Trust Fund, if loan defaults reduce the trust fund balance to the extent additional funds are necessary to maintain a 5:1 reserve ratio for outstanding loans. Joint Legislative Budget Committee (JLBC) notification would be required.

Staff Comment: To correctly reflect the installment appropriation for the $84.4 million grant, the Joint Legislative Budget Committee approved $27.8 million in federal expenditure authority for the Small Business Loan Guarantee Program in 2010-11 on March 25, 2011. The 30-day review period was waived so that the program would be positioned to meet the federal government's expectations for use of these funds.

The April 1st Letter proposes budget changes to correctly reflect the multi-year payment of the federal grant. The language would place $27.8 million into the Small Business Expansion Fund (consistent with federal regulations) for 2011-12.

This is recommended as vote-only because this is a technical fix, to correctly schedule the federal grant by fiscal year – there are no substantive changes to the proposal.

Staff Recommendation: Adopt the Administration's April 1st scheduling of federal funds, but maintain prior Subcommittee Action related to administrative costs and budget language.

STATE CONTROLLER'S OFFICE (0840)

For overview and budget information regarding the State Controller's Office (SCO), please see page 33 of this agenda.

Issue 1 – Increased Postage Expenses

April Letter Request. In an April Finance Letter, the Governor requests increased expenditure authority of $43,000 (reimbursements) in 2010-11 and $217,000 (reimbursements) in 2011-12 and ongoing, for increased postage expenses.

Background. The SCO is the chief financial officer of the state, whose responsibilities include mission critical functions such as general disbursements of payments and other mailings, which require postage. The cost of postage represents approximately 27 percent of the SCO's total ongoing 2011-12 Operating Expenses and Equipment budget. Actual postage costs for 2009-10 were $13 million and are budgeted at $14.2 million for 2010-11. As a result of the most recent United States Postal Service (USPS) rate increase, effective on April 17, 2011, the SCO estimates an increased cost of $61,000 in 2010-11 and $272,000 in 2011-12 and ongoing. Cognizant of the pressures on the GF, the SCO is requesting support for only the reimbursement share of the cost increase through this April letter.

Through an approved 2010-11 budget request, the SCO budget was augmented by $874,000 (various special funds) for projected increased costs in rent and an anticipated increase in postage costs; the total provided was split roughly evenly between the two cost areas. The postage increase did not occur. The SCO reports that the 2010-11 funds for the postage increase have not been spent and will instead be reverted at the end of this fiscal year.

Staff Comment. The SCO's 2010-11 budget was augmented by $442,000 for a postage increase that subsequently did not happen; as noted above, those funds have not been spent and will revert at the end of this fiscal year. On April 17, 2011, a postage increase was implemented.

Staff Recommendation. Approve the April letter.

Issue 2 – Transportation Audits Indirect Allocation Plans

April Letter Request. In an April Finance Letter, the Governor requests continuation of 12.6 positions and $1.751 million (reimbursements) on a two-year limited-term basis to authorize the Controller to continue providing audit services for Indirect Cost Allocation Plans (ICAPs) for Local Government Agencies (LGAs) on an interagency agreement with the California Department of Transportation (Caltrans).

Background. In the 2009-10 budget, the SCO received similar funding on a two-year limited term basis to provide, through an interagency agreement, audit services to Caltrans for audits of ICAPs for LGAs. This request would continue the ability of the SCO to provide these audit services to Caltrans. The ICAP audits are mandated by the Federal Highway Administration of LGAs that receive federal transportation funding. The purpose of an ICAP is to equitably allocate allowable indirect costs of an LGA to benefiting projects/cost objectives through an annual indirect rate. Audits of submitted ICAPs for the last two fiscal years have resulted in a reduction of indirect costs by more than $14 million per year due to discovery of errors and unallowable costs.

Staff Comment. On April 28, 2011, Senate Budget Subcommittee No. 2 on Resources, Environmental Protection, Energy and Transportation approved an April letter from Caltrans for the Caltrans side of this interagency agreement for audit services. The resources requested are limited-term, which is appropriate as the SCO indicates the federal audit requirements may change in future years. In approving this request, staff also recommends inclusion of Supplemental Reporting language to require the SCO report to the Legislature regarding federal audit requirements prior to the next fiscal year with a reporting date of March 1, 2012.

Staff Recommendation. Approve the April letter and supplemental reporting language.

DEPARTMENT OF INSURANCE (0845)

Department Overview. The California Department of Insurance (CDI) regulates the California insurance market and enforces the California Insurance Code, conducting examinations and investigations of insurance companies and producers and working to ensure the financial solvency of companies so that they will meet their obligations to policyholders and claimants. CDI investigates more than 300,000 complaints annually and responds to consumer inquiries. CDI also reviews and approves insurance rates to enforce the statutory requirement that rates are not excessive or unfair. CDI also administers the conservation and liquidation of insolvent and delinquent insurance companies and fights insurance fraud in conjunction with local and state law enforcement agencies.

Budget Overview. The January Governor's Budget provides CDI with 1,338 authorized positions and $224.94 million (Insurance Fund and reimbursements). This is an increase of 71 positions and $16.4 million.

Issue 1 – Workers' Compensation Insurance Fraud Program: Local Assistance Workload Increases

April Letter Request. In an April Finance Letter, the Governor requests increased expenditure authority of $1.646 million (Insurance Fund) local assistance in 2011-12 and ongoing to fund local District Attorney workers' compensation fraud investigation workload increases.

Background. The Workers' Compensation Fraud Program (WCFP) was established in 1991 (Chapter 116; Statutes of 1991), thereby making workers' compensation a felony, requiring employers to report suspected fraud, and establishing a mechanism for funding enforcement and prosecution activities. The Fraud Assessment Commission (FAC) was also established and mandated to annually determine the level of employer paid assessment necessary to fund investigation and prosecution of workers' compensation insurance fraud. Under law, this funding is restricted and cannot be used for any other purpose; after incidental expenses, at least 40 percent of the funds are provided to the DOI Fraud Division for enhanced investigative efforts, and at least 40 percent of the funds are distributed to local District Attorneys. At its September 8, 2010, meeting, the FAC approved an assessment of $31.874 million for local assistance, a 6.5 percent increase over 2010-11 funding. By approving this request, the expenditure authority for the District Attorneys' portion of the WCFP will be appropriately aligned with the current FAC assessment.

Staff Recommendation. Approve the April letter.

CALIFORNIA ALTERNATIVE ENERGY AND ADVANCED TRANSPORTATION AUTHORITY (0971)

For overview and budget information regarding the California Alternative Energy and Advanced Transportation Authority, please see page 31 of this agenda.

Issue 1 – Energy Upgrade California Program

Governor's Request: In an April 1 Finance Letter, the Administration requests an increase of $205,000 in reimbursements for CAEATFA to assist the California Energy Commission (CEC) by providing financial services for the Energy Upgrade California Program (EUC) which is funded by the federal American Recovery and Reinvestment Act (ARRA) of 2009. This request follows the Section 28 request submitted to the Department of Finance in the amount of $4.3 million for the current year.

Background: The CEC received $315 million through ARRA for energy-related projects and rebates. As part of this project CEC developed the EUC, a statewide energy and water efficiency and renewable energy generation retrofit program and contracted with the Local Government Commission (LGC) to run the program. LGC, in turn, has subcontracted with CAEATFA to provide financial services with respect to financial products and lending standards and financial subsidies.

The total amount of the program request is $4,523,000 ($4,318,000 in the current year pursuant to the Section 28 letter and $205,000 as a component of this BCP) through ARRA funding. The funds will be used for staff services, financial subsidy funds, trustee costs, financial advisor services, legal services, travel, and overhead.

This issue is suggested for vote only because the Joint Legislative Budget Committee approved the 2010-11 Section 28 letter for $4.3 million, which represents most of the program funding. The April Finance letter would conform to the JLBC action.

Staff Recommendation: Approve the April letter.

DEPARTMENT OF CONSUMER AFFAIRS (1110)

Departmental Overview and Mission. The Department of Consumer Affair's (DCA) Boards and Bureaus provide exams and licensing, enforcement, complaint mediation, education for consumers, and information on privacy concerns. DCA Boards and Bureaus establish minimal competency standards for more than 255 professions involving approximately 2.4 million professionals. There are currently 25 boards, a commission, three committees, and eight bureaus under the broad authority of the DCA.

Budget Overview. The Boards are budgeted under organizational code 1110, and the total proposed budget is $271.46 million (no GF) and 1,511.3 positions – an increase of $10.4 million and 35.6 positions over 2010-11.

The Bureaus are budgeted under organizational code 1111, and the total proposed budget is $231.34 million (no GF) and 1,386.6 positions – an increase of $14.2 million and 5.7 positions over 2010-11.

Issue 1 – Board of Professional Engineers and Land Surveyors Licensing Exams

April Letter Request. The Governor requests $1.124 million (one-time special funds) for the Board for Professional Engineers, Land Surveyors, and Geologists for fees to the National Council of Examiners for Engineering and Surveying to administer the national examinations to California applicants.

Board of Professional Engineers and Land Surveyors. The mission of the Board for Professional Engineers and Land Surveyors (BPELS) is to safeguard the life, health, property, and welfare of the public by regulating the practice of professional engineering and land surveying. In 2009, legislation was enacted that eliminated the Board for Geologists and Geophysicists and transferred all of the duties, powers, purposes, responsibilities, and jurisdiction to regulate the practices of geology and geophysics to the Board for Professional Engineers and Land Surveyors.

Licensing Exams. The California Business and Professions Code mandates the BPELS to receive applications for licensing, ensure that an exam for licensure is available and accepted in California, and ensure that each exam type is available at least once a year.

Currently, there are 16 different national exams and six state-specific exams for engineers, land surveyors, and geologists offered within California. The National Council of Examiners for Engineering and Surveying (NCEES) develops the national exams used by California. The national exams ensure that individuals licensed in California are accepted for license reciprocity in the other 39 states that use NCEES examinations and out-of-state applicants can gain licensure in California. The exams are administered by BPELS.

Security Breach. In April 2010, the BPELS found that an exam booklet was missing. The NCEES Board determined that the integrity of the exam process had been breached. The NCEES informed the BPELS that if California is to retain access to the national examinations, it must contract with NCEES to administer the examinations. BPELS has a financial liability for all compromised exams, and the amount of the liability varies by exam type. California's liability for the security breach is $2 million, and potential future liability is up to $7.6 million for all national engineering exams provided in California.

Cost of Providing Examinations. Currently, the BPELS administers 22 exams at a cost of approximately $2.45 million annually. This cost includes a $1.8 million contract with NCEES for the use of the NCEES exams. Once BPELS amends state regulations to allow for computerized testing, the contract funds to NCEES will be removed from the BPELS budget, thus saving the state funds in the long-term. After the computerized testing is allowed for, the payment NCEES will receive for administering the exams will come directly from the licensed population in the form of exam fees.

In 2011-12, the one-time funds will pay additional fees to NCEES to administer the exams, while BPELS amends state regulations to allow for a computer-based testing format and lowers the state licensing fees. Additionally, by having NCEES administer the exams, California is released from liability for exam security breaches.

Staff Recommendation. Approve the April letter.

FRANCHISE TAX BOARD (1730)

For overview information regarding the Franchise Tax Board (FTB), please see page 22 of this agenda.

Issue 1 – Data Security and Reliability: Enterprise Tape Library

April Letter Request. The Governor requests shifting $2.29 million approved last year to replace FTB's Enterprise Tape Library from the current year to 2011-12. The expenditure of these funds has been delayed and this proposal would better align the funding to the correct fiscal year. The April Finance Letter is also requesting $2.27 million in 2012-13 to complete the replacement. This delay in expending these funds has not impacted the project costs or the final completion date of the project.

Background. Data security and reliability is critical for FTB given the volume of confidential taxpayer data it maintains. The FTB has employed a defense-in-depth strategy to protect this information where multiple layers of defense are placed throughout its information technology system so that if one fails there are others layers that prevent against a security attack.

Furthermore, the FTB's data reliability is being threatened by outdated equipment and software that is out-of-support. For example, the FTB's Enterprise Tape Library System, which is critical to providing continuous access to the up-to-date accurate information that FTB's automated systems rely on, is at risk of failure. If this system failed, FTB's productivity could be severely hampered and data security could be compromised.

Staff Recommendation. Approve the April letter.

Issue 2 – Voluntary Contribution Funding Codes – Budget Bill Clean-Up

April Letter Request. The April Letter includes amendments to the budget bill to add four new funds and delete four funds that did not meet the voluntary contribution limits required to remain on the state tax return. The four additions that were established by Statutes in 2010 include the following:

- Arts Council Fund
- California Police Activities League (CALPAL) Fund
- California Veterans Home Fund
- Safely Surrendered Baby Fund

The four funds that did not reach the $250,000 threshold for contributions and are proposed to be eliminated include the following:

- ALS/Lou Gehrig's Disease Research Fund
- California Military Family Relief Fund
- California Ovarian Cancer Fund
- Municipal Shelter Spay and Neuter Fund

Background. Current law allows taxpayers to contribute amounts in excess of their tax liability to various voluntary contribution funds listed on the state tax return by checking a box on their California income tax form. These funds must reach the minimum level of $250,000 in their second taxable year. If they do not meet the $250,000 minimum, the law authorizing these fund designations is repealed.

Staff Comments. This proposal is strictly limited to adjusting the budget bill to properly align existing law with the budget bill. The underlying statutes authorizing the voluntary contribution funds are automatically repealed when the minimum threshold is not met.

Staff Recommendation. Approve the April letter.

DEPARTMENT OF REAL ESTATE (2320)

For overview information regarding the Department of Real Estate (DRE), please see page 37 of this agenda.

Issue 1 – SB 36 Mortgage Loan Originator Licensure (SAFE Act)

Governor's Budget Request. The Governor requests $216,000 (Real Estate Fund) and two positions for continued implementation of the federally mandated Secure and Fair Enforcement Licensing Act of 2008 (SAFE Act) which requires states to implement a new licensing program for mortgage loan originators (MLOs).

2010-11 Budget. The 2010-11 budget included $2.8 million (Real Estate Fund) and 27 positions to begin implementation of the SAFE Act.

Prior Subcommittee Action. This request was denied without prejudice at the Subcommittee's January 25, 2011, hearing so that all factors and the DRE's resources could be considered at one time (it was indicated to staff that the DRE might have additional requests related to SAFE Act implementation during Spring budget hearings). Further, the Senate Business and Professions Committee held an oversight hearing on February 28, 2011, focused on DRE enforcement and consumer protection issues. The DRE now reports that there are no additional requests forthcoming with the exception of Issue 1 on page 37 of this agenda, an April Finance Letter related to the relocation and consolidation of the DRE's Headquarters and Examination Center.

Background. The federally mandated SAFE Act requires all states to license and register their MLOs through a nationwide registry called the National Mortgage Licensing System (NMLS). Chapter 160, Statutes of 2009 (SB 36), brought California into compliance with the SAFE Act by requiring those engaging in MLO activities to obtain a license from the Department of Corporations or, if a real estate licensee, obtain a license endorsement from the DRE.

At this point in the SAFE Act implementation process, the main drivers of the additional licensing and enforcement workload for the DRE was the MLO notification in 2010 and ongoing license endorsement renewal process and the annual Business Activities Report and Call Report requirements for all MLO brokers, respectively. With regard to enforcement activities, the workload will be driven by the number of NMLS registrants required to file the mandated reports and the timing of the submission of those reports. More specifically, the Business Activities Reports are first due on a rolling basis beginning on January 2, 2012 (the reports have to be submitted within 90 days after the end of the broker's first fiscal year; April 2, 2012, is the final date these first reports could be filed with the DRE to meet the 90-day requirement). The Call Reports are required to be submitted on a quarterly basis beginning May 15, 2011.

Staff Comment. In approving SB 36, the Legislature approached SAFE Act compliance in a narrow sense by requiring a new endorsement on existing real estate licenses. Licensees pay a $300 fee for that endorsement. Staff notes that while this approach has resulted in the least disruption to existing systems and minimized compliance costs to both the state and licensees, the SAFE Act has represented, and will continue to represent, new workload for DRE. However, due to the timeline when SAFE Act enforcement activities will commence in earnest, the actual workload data is still relatively unknown. Additionally, the DRE has indicated that it is exploring available business analytic technology opportunities to substantially reduce the number of positions needed to review the required reports. The Administration has confirmed that the approach is for the DRE to submit a new comprehensive SAFE Act-related request in a future budget cycle rather than taking a fragmented approach, such as that contained in this request.

Staff Recommendation: Deny the request.

DEPARTMENT OF PERSONNEL ADMINISTRATION (8380)

Department Overview. The Department of Personnel Administration (DPA) is the Governor's chief personnel policy advisor. DPA represents the Governor as the "employer" in all matters concerning state employer-employee relations. DPA is responsible for all issues related to salaries, benefits, and position classification. For rank and file employees, these matters are determined through the collective bargaining process; for excluded employees, these matters are determined through a meet and confer process.

Budget Overview. The January Governor's Budget provides the DPA with 246 authorized positions and $86.4 million ($9.3 million GF). This is an increase of zero positions and $625,000.

Issue 1 – Removal of Recruitment Contract Funding and Language

April Letter Request. In an April Finance Letter, the Governor requests a reduction of $350,000 GF in 2011-12 and removal of provisional budget bill language to reflect the fiscal year 2008-09 expiration of recruitment contracts for medical professionals.

Background. In the 2007-08 Budget, the Legislature approved on a two-year limited-term basis an augmentation of $350,000 GF and provisional budget bill language for recruitment contracts for medical professionals. The funding and language should have been removed in the 2009-10 Budget when the limited-term period expired. For unknown reasons, this action was not taken; therefore, the funding and provisional language remained in DPA's budget.

Staff Comment. According the DPA, the $350,000 GF was not expended in 2009-10 and the DPA reports that it has not and does not intend to spend those funds. However, the DPA does have the ability to still liquidate the funds should they chose to since departments have one year to encumber and two years to liquidate. The 2009-10 funds in question, therefore, could "last" until the end of 2011-12.

With regard to the $350,000 GF contained in the 2010-11 budget, the DPA reports that the funds have also not been expended. Therefore, in its consideration of this request, the Subcommittee may wish to consider adopting budget bill language to revert the 2010-11 funds, as well as the 2009-10 funds, thereby ensuring that the DPA no longer has the ability to access these funds, for additional savings of $700,000 GF.

Staff Recommendation: Approve the April letter to delete the provisional budget bill language and reduce DPA's budget by $350,000 GF in 2011-12; additionally, adopt new reversion items in the 2011-12 budget to realize an additional $700,000 GF savings combined from 2009-10 and 2010-11.

INFORMATION TECHNOLOGY

Issues Proposed for Discussion / Vote

Issue 1 – California Technology Agency (0502) 2009 Governor's Reorganization Plan No. 1

Background. On May 10, 2009, the Governor's Reorganization Plan No. 1 (GRP) took effect thereby beginning the process of consolidating statewide information technology (IT) functions under the California Technology Agency (formerly the Office of the State Chief Information Officer, or OCIO). Since that time, the primary strategic objective has been to transform state government to become more responsive to Californians' needs and to operate more efficiently and transparently through the use of technology.

As required by statute, each year the California Technology Agency (Technology Agency) has updated the state's IT Strategic Plan (first adopted in 2009). The 2011 Statewide IT Strategic Plan streamlines and further clarifies the strategies articulated in the 2009 and 2010 Strategic Plans, and contains the following three strategic goals: (1) Make Government Transparent, Accessible, and Secure; (2) Drive Innovation and Collaboration; and (3) Make Information Technology Reliable and Sustainable Through Consolidated Platforms and Shared Services. In short, and through the implementation of the GRP, the California Technology Agency (Technology Agency) seeks to consolidate the state's IT infrastructure while laying the groundwork for more robust and more sustainable platforms, improve project management practices, oversight, and training, and create an architectural framework to reduce redundancy and improve operations.

Current statute also requires the Technology Agency to produce an annual IT performance report consisting of a variety of assessments and measurements, including the progress made in enhancing IT human capital management, improving the IT procurement process, and enhancing the security, reliability, and quality of IT networks, services, and systems. The Technology Agency is also required to post these performance targets and progress towards these targets to its public internet web site. Finally, current statute requires the Technology Agency to report, at least annually, to the Director of Finance cost savings achieved through improvements to the way the state acquires, develops, implements, manages, and operates state technology assets, infrastructure, and systems.

Chapter 404, Statutes of 2010 (AB 2408) codified the GRP and defined targets and timelines for IT consolidation across the executive branch, including modernizing the state's IT infrastructure to increase efficiency, reduce energy usage, and save costs. With the Technology Agency taking the lead, departments are now required to meet the following mandates: (1) achieve a 20 percent reduction in energy usage by July 2011, and 30 percent by July 2012; (2) achieve a 50 percent reduction in data center raised floor space by July 2011; (3) transition mission-critical and public-facing applications to Tier III data centers and close all other existing server rooms by June 2013; (4) begin migrating from existing network services to the California Government Network no later than July 2011; and (5) begin migrating to the state's shared e-mail solution no later than June 2011.

Chapter 404 also made changes to the IT procurement process to coordinate IT resources across the executive branch. Effective January 1, 2011, departments and agencies are now required to submit IT solicitations (Requests for Proposal) valued at more than $1 million to the Technology Agency and the Department of General Services prior to releasing to the public. Prior to this statutory change, the Technology Agency was not formally included in the IT solicitation process.

Staff Comment. Prior to the adoption of the GRP, state IT had been largely decentralized for years. The GRP, therefore, represented a new and substantial change of course. Since its approval in 2009, Subcommittee No. 4 has annually "checked-in" on the status of its implementation. In those hearings, the Subcommittee focused on examining how IT functions and resources have been streamlined, how statewide IT policies have been standardized, the status of efforts to meet the performance metrics contained in the GRP, and the savings achieved (or to be achieved). All of these areas are valid and the Technology Agency has made great strides in achieving the goals of the GRP; these areas are all also largely captured within existing reports, such as the annual IT strategic plan or other statutorily-required reporting mechanisms. Therefore, as we near the two year anniversary of the adoption of the GRP, and cognizant of the fact that the implementation of the GRP is and will continue to be an evolving process, staff recommends today's discussion focus on what further improvements are needed to what information related to the implementation is collected and how that information is reported and shared to ensure that a complete picture of the implementation is provided on an ongoing basis.

Staff notes that one of the challenges to date with the story of the GRP is that a particular focus has been placed on savings. This is understandable, especially in light of the state's fiscal condition, but it is important to acknowledge that the GRP resulted in some new upfront costs in the early years with likely greater out year savings. This fact likely offset some of the immediate achieved savings. Additionally, capturing IT savings is a challenge as day-to-day IT expenditures are not a defined budget expenditure. Rather, IT expenditures are largely included in departmental Operating Expenses and Equipment funds (and paid to the Technology Agency through rates charged for products and services provided) which makes it difficult to have effective expenditure control mechanisms.

As identified below, it is clear that the Technology Agency is making strides to generate savings though reduced data center square footage, improved energy usage, and decreased server usage, but capturing that savings is difficult (primary reason why savings through a control section is unsuccessful). For example, reducing the data center square footage and the number of servers housed at the data center may result in decreased rates charged by the Technology Agency, but increased storage capacity, staff costs, or usage requests may result in increased rates charged. In this example, if a 3-cent rate decrease is offset by a 3-cent rate increase, the client department sees no change in costs; savings are not captured, but we know the job is being done more efficiently.

This singular focus on savings also misses other key and valid parts of the story where successes have been achieved but have not been reported. For instance, another outcome of the GRP that has proven difficult to quantify are the costs (and risks) that have been avoided in the past two years. The Technology Agency has provided information to staff indicating that, since it was established in 2008 (formerly the OCIO), the state has achieved more than $800 million in savings and cost avoidances through numerous technology initiatives including state-wide IT consolidation, IT Project Oversight, IT Capital Plans, IT Acquisition Plans, annual IT Cost Reporting, and contract renegotiations. Examples of those savings/avoidances include:

- Reduced data center square footage by more than 100,000 square feet. The space savings alleviated the need for a new data center facility, eliminating more than $40 million in capital costs and $24 million in annual operating expenses.
- Identified more than $693 million in cost avoidance through the IT Capital Planning process.
- Reduced IT consultant contracts by $17 million and IT project costs by $52 million through the IT Acquisition Planning process.
- Renegotiated the CalNet 2 contract reducing telecommunications costs to state agencies by $25 million annually.
- Conducted an assessment of wireless rates resulting in more than $3 million in savings to state agencies.
- Reduced data center rates charged to state agencies by $23.94 million:
  - $8 million in rate reductions due to network consolidation.
  - Storage rates have gone down by more than 90 percent since 2008 (from $24 per gigabyte per month to $2 per gigabyte per month).

However, this information on cost (and risk) avoidance is not currently widely reported or shared. Therefore, staff recommends the Subcommittee consider adopting both budget trailer bill and supplemental report placeholder language to improve upon existing reporting metrics to capture these types of additional elements of the GRP implementation efforts. Developed collaboratively with the LAO, Technology Agency, and DOF, the additional metrics would include: (1) reporting on cost (and risk) avoidance and (2) any potential impairments that have been identified to the continued successful implementation of the GRP. Additionally, staff recommends that through the adoption of additional placeholder supplemental reporting language a process be established to convene an annual meeting on the overall status of the implementation of the GRP, and more specifically on lessons learned to date and what barriers to success have been identified. Finally, staff recommends that a copy of the annual report on IT savings also include cost avoidances and that report be transmitted to the Joint Legislative Budget Committee and fiscal committees of both houses of the Legislature.

As the Subcommittee considers these issues, it may wish the Technology Agency and Administration to respond to the following questions:

1. The Technology Agency has identified more than $693 million in cost avoidance through the IT Capital Planning process. What specific examples can the Technology Agency share with the Subcommittee to better delineate these savings? Are there examples of IT projects that were denied? Can the Technology Agency point to an example where the efforts of two departments pursuing similar projects were combined, thereby achieving some measure of economies of scale?
2. One of the functions consolidated in GRP 1 was “human capital management.” Could the Technology Agency briefly describe the changes that have been implemented with regard to IT human capital?
3. How has the Technology Agency addressed IT project management in the past year? How has the Technology Agency used project management resources to address projects like 21st Century and FI$Cal (Issue 4 below), which are in process?
4. Savings are either one-time or ongoing. For the savings achieved to date, what percentage is one-time versus ongoing? How will that ratio change over time?

Staff Recommendation: Approve placeholder budget trailer bill language and supplemental report language to improve reporting and information sharing related to the implementation of the GRP.

Vote: Staff recommendation approved by 3-0 vote.

Issue 2 – California Technology Agency (0502) Independent Project Oversight

Governor's Budget Request. The Governor requests $966,000 (Technology Services Revolving Fund) and nine permanent positions for Independent Information Technology Project Oversight (IPO) in 2011-12 and ongoing to meet workload increases and mandated responsibilities of Chapters 183 and 404, Statutes of 2007 (SB 90) and Statutes of 2010 (AB 2408), respectively, and to ensure consistent project implementation of the state's IT projects.

Prior Subcommittee Action. This request was denied without prejudice at the Subcommittee's February 7, 2011, hearing, so that all factors and the Technology Agency's (Technology Agency) resources could be considered at one time (it was indicated to staff that the Technology Agency might have additional related requests during Spring budget hearings). The Technology Agency reports that there are no additional requests forthcoming.

Background. The increased expenditure authority in this request is for a staffing expansion that the Technology Agency considers a critical priority due to legislative mandates, increased public visibility, and the need to ensure consistent project implementation of the state's IT projects. These positions would provide independent project management services to customer departments. These positions are also consistent with the GRP, and its goals of enhancing IT human capital management. The costs associated with the IT project management will be funded by the agency or department administering the project; the Technology Agency would be reimbursed 100 percent by the department or agency requesting the services. Once the Technology Agency has created a professional state governmental entity, comprised of state staff, to manage and direct IT policy, standards, and projects, the state's current reliance on high paid contractors will be diminished. The state currently spends approximately $17.2 million annually on contracted IT project oversight and management.

Staff Comment. The proposed positions represent the beginning of the implementation of the Technology Agency's expanded role as outlined in Chapter 404. Staff concurs that having IPO conducted in-house (as opposed to contracted out) will save the state as the state will eventually no longer rely on highly paid contractors and will instead have developed a cadre of IT professionals within state service.

Staff Recommendation: Approve the request.

Vote: Request approved by 3-0 vote.

Issue 3 – Franchise Tax Board (1730) Enterprise Data to Revenue Project

Background. The Franchise Tax Board (FTB) is one of the state's two major tax collection agencies. The FTB's primary responsibility is to administer corporation tax programs and California's personal income tax (PIT). In addition, FTB administers several non-tax-related programs, including the collection of child support payments and other court-ordered payments. The FTB is governed by a three-member board, consisting of the Director of Finance, the Chair of the Board of Equalization (BOE), and the State Controller. An executive officer, appointed by the board, administers the daily operations and functions of FTB.

The Conference Report (SB 69, Budget) passed by the Legislature on March 17, 2011, contains $547.9 million General Fund to support FTB's operations.

The number of personnel-years (PYs) for FTB is budgeted to decline slightly from 5,434 to 5,260.

Tax Gap Reduction Measures

Summary. The FTB estimates that its total tax gap is about **$6.5 billion**. The tax gap is defined as the total tax receipts due to the state less the tax receipts collected by FTB. The department has undertaken several initiatives over the last six years to reduce this tax gap using an enterprise approach. An enterprise approach means that staffs from all different divisions at FTB are involved in reducing the tax gap, including filing, audit, legal, and collections divisions.

1. Enterprise Data to Revenue Project

Background. The FTB's tax filing system has not been substantially updated in the last 25 years. In order to modernize the FTB's filing system, the board initiated the Enterprise Data to Revenue (EDR) Project two years ago. This project will introduce a new PIT and Business Entity return processing system including expanded imaging, data capture, and return validation. Annually, the FTB processes approximately 15 million PIT returns and one million Business Entity returns.

Overall, this project will enable FTB to correct erroneous returns in a timelier manner. It will also be more effective at providing data to identify noncompliance patterns and help identify fraudulent activity. This data system will also allow FTB to better prioritize its workload based on highest cost recovery. The FTB indicates that the new system will also expand self-help tools for taxpayers and tax practitioners to improve the filing and payment activities.

The FTB is using an alternate type of procurement for the EDR project that invites bidders to propose a comprehensive solution to address the overall goals outlined by the EDR project, instead of dictating the solution to the bidders. In this type of procurement, the State enters into a contract with a **Primary Solution Provider (PSP)** and the State works collaboratively with the provider to find a solution that meets the goals of the State. The FTB received proposals last year and chose a PSP in November 2010.

The FTB is also using a **benefits based procurement model** to acquire the EDR Project and get the best value and business driven solution. This model is based on acquiring innovative solutions to strategic business problems and only compensating the contractor when these solutions deliver new tax revenues and after certain State costs are recouped. Revenue benefits are then shared with the contractor up to a fixed contract amount. Furthermore, the contract is constructed so that the State does not incur upfront expenses to compensate the contractor.

When fully implemented, the FTB estimates that the EDR project will bring in over **$1 billion in ongoing revenue annually**. This will help to address the $6.5 billion annual tax gap through increased collection of tax revenues that are due to the State but currently unpaid or uncollected for various reasons. Overall, the **one-time costs of the PSP contract are estimated to be $398.9 million** over the life of the 66-month (5.5 year) contract. This is significantly more than earlier anticipated costs of the project ($234 million). However, the State is now estimating that the proposed solution by the vendor will generate approximately $1 billion more in revenues over the life of the project.

Finance Letter. The Governor's April 1 Finance Letter requests $28.9 million General Fund to support the EDR project in the budget year. Last year, the Legislature approved a $10.2 million request, including 72 new positions. These costs will be more than offset by the additional revenues that the FTB estimates will be received in the 2011-12 fiscal year. The FTB anticipates generating $65.3 million in additional revenues in 2011-12 which is nearly $40 million more than initially anticipated prior to the FTB receiving the PSP solution.

Specifically, the funding requested in the budget year supports the following expenditures:

1. **Personal Services.** Includes $3.9 million for support of personal services. However, no additional positions are provided in this budget proposal. The department has indicated that it will redirect existing vacant positions to support this proposal in the short term.
2. **PSP Contract.** Initial compensation benefits ($25 million) to the PSP paid from additional revenues collected due to the implementation of several "early win" deliverables that will result in additional revenues in the first two to 18 months. Some of the early win deliverables are business process changes that do not require the entire information technology solution to be in place, including making changes to the tax forms to adjust for common mistakes related to real estate deductions and adding additional fields of data to the Accounts Receivable Collection System database.
3. **Independent Verification and Validation (IV&V) Contract.** Funding ($1.3 million) to acquire an IV&V contractor which is a standard practice of the State when entering into contracts for large information technology projects.
4. **Cost Reasonableness Contract.** Funding ($110,000) for Cost Reasonableness consultant services. This consultant will act as another check and balance on the main PSP contract to ensure that the costs charged to the State in delivering the project are reasonable and not outside the normal industry standards.

Staff Comments. Overall, staff finds that the EDR project has been thoroughly planned and the FTB has obviously done significant work to ready the organization for the implementation of the new system, including a complete documentation of their business processes. However, the proposed solution by the PSP has a considerably different cost and revenue structure than originally estimated. It will be critical that the state monitor how the estimated cost and revenue structure of this project tracks with actual revenues and expenditures. Furthermore, the calculation of the revenues attributable to the EDR project is essential to evaluating the relative value of the PSP contract.

- **FTB.** Can you please describe the process you are putting in place to measure what revenues benefits are attributable to the EDR project?
- **FTB.** How will major amendments to the PSP contract be handled if outcomes turn out to be different than estimated?

The Finance Letter assumes that a Section 11 is submitted in the current fiscal year to allow the state to enter into the contract with the PSP. This has not been received.

- **DOF.** What is the status of the Section 11 request for the current year?

Overall success in implementing a new information technology solution requires careful planning and training so that the users interfacing with the system can be successful in transitioning to the new system.

- **FTB.** What steps has FTB put in place to build in redundancy in the system in order to improve outcomes and ensure a smooth transition?
- **FTB.** What steps has FTB taken to ensure adequate training for the workforce transitioning to the new system?

The FTB received authority to hire 72 additional positions to support the EDR project last year. Staff understands that they need to fill an additional 52 positions to support the EDR project in the budget year for a total of 124 positions. The FTB has not received authority to hire 52 new positions in the budget year and is planning to redirect vacant positions internally to address the EDR workload. The April Finance Letter includes $3.9 million General Fund to support these redirected positions because these redirections would bring FTB's vacancy rate below 5 percent. (It is standard state budgeting practice to assume 5 percent [salary] savings when funding positions.) The FTB indicates that the redirection can be managed in the interim, but staff finds that the ongoing success of the project could be jeopardized if the implementation of the EDR solution is significantly under resourced – potentially leading to a pennywise pound foolish result. Furthermore, other revenue generating aspects of FTB's operations could be negatively impacted by the redirection.

- **FTB.** What are the main categories of staff needed to implement the EDR solution?
- **FTB.** Will these redirections have an impact on FTB's operations?

Staff Recommendation. Hold this issue open pending receipt of the 2010-11 Section 11 request.

Item held open.

Issue 4 – Financial Information System for California (FI$Cal) (8880) Budget Request for 2011-12

Department Overview: 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$Cal system will be implemented in several phases, or "waves," over the next decade. Budget Control Section 8.88 is a technical fiscal provision that directs special funds to the FI$Cal project and it will be made to conform to the final budget adopted under the 8880 budget items.

January Budget Overview: The January Governor's budget proposed $70.8 million ($20.9 million GF) for continuing the FI$Cal project. This represents a year-over-year increase of $29.0 million ($5.2 million GF). Funded positions would grow from 62.1 to 95.9. The reason for the funding increase is that the project would be moving into the implementation stage with contract award to the vendor by December 31, 2011. The 12-year cost of fully implementing the project is estimated at $1.6 billion (both GF and other funds). The Administration is exploring financing options such as bonding and vendor-financing to spread costs over a longer period.

Current Budget Status: In February, the Subcommittee maintained the funding level proposed by the Governor, but indicated the FI$Cal budget would be reviewed further and heard again in the spring. The Subcommittee expressed concern about the GF cost of the FI$Cal project given the budget shortfall.

Governor's Revised Budget Request: The Administration has issued a Spring Finance Letter that redefines the budget year request for the FI$Cal project to reduce costs in 2011-12 and reflect the new project schedule. The new request reduces the requested funding for the budget year by $32.4 million ($18.4 million GF), and pushes the project schedule back by about 4 months. The revised budget proposed for 2011-12 is $38.5 million ($2.5 million GF). The request for 33 new positions made in January, would also be withdrawn.

Project Timeline: Currently, three selected vendors are completing the "Fit-Gap," or stage I contract, which involves a review of potential gaps between the vendor's software and the state's business requirements. Project staff have also asked the three vendors to propose financing options and have held discussions with the State Infrastructure Bank (I-Bank) on financing options. The following are key upcoming dates, as revised in the April Finance Letter:

- **June 2011** – Proposals due from the competing vendors.
- **January 2012** – Submission of Report to the legislation outlining the proposed vendor and IT solution.
- **April 2012** – Award of system contract (contingent on legislative support).

Project Financing: The FI$Cal project has produced a white paper on funding options. The paper outlines the following three options for financing the FI$Cal project:

- **Pay-Go**: Fund project costs in the budget as these costs are incurred, which results in the lowest overall project costs, but requires huge up-front costs in 2012-13 to 2017-18;
- **Vendor Financing**: Some of the contract costs would be financed through the vendor to help reduce the initial costs and spread out the costs over an additional five years; and,
- **I-Bank/Bond Financing**: Provides the lowest up-front costs, but has the highest overall costs by spreading costs over 15 years.

Staff Comments: The FI$Cal project is a multi-year effort which is completing its third year as a stand-alone budget item. Fiscal year 2011-12 is a pivotal fourth year for the project, in which the Administration will select a preferred product and partner, as well as a financing plan. The Administration will present the proposal to the Legislature for their review in the winter and spring of 2012. To the degree the solution proposed next year has the Legislature's support, the fiscal cost in 2012-13 can be managed through defining the speed of the roll-out and the financing strategy.

Staff Recommendation: Approve the FI$Cal budget as modified by the April Finance Letter.

Vote: Staff recommendation approved by 3-0 vote.

Issue 5 – Secretary of State (0890) California Business Connect Project: Phase I

April Letter Request. In an April Finance Letter, the Governor requests one-time increased expenditure authority of $1.16 million (Reimbursements) for Phase I of the California Business Connect Project, scheduled to begin in July 2011 with a projected completion date of June 2016.

Prior Budget Actions. Initially funded in 2001, with total project costs of $33.6 million (roughly $31.6 Business Fees Fund with remainder from the Business Reinvestment Fund) the Legislature approved the SOS's Business Automation (BPA) Project, which was expected to automate and modernize business processes. The BPA was approved for two phases, with Uniform Commercial Code (UCC) filings and other lien-related filings as the first phase and Business Entities, Special Filings, and Trademarks as the second phase. The BPA resulted in the customization and modification of a commercial-off-the-shelf product to support the statutory and business requirements for UCC and other lien-related filings. After the UCC phase was implemented in 2006, the vendor notified the SOS that their business model had changed; therefore, the BPA scope was reduced to the first phase only. As of January 1, 2010, the BPA vendor no longer provides maintenance and operational support for the UCC system; replacement of this system is scheduled in the final phase of the Business Connect project.

The 2010-11 budget included $1 million (Business Fees Fund) over two years to reduce the current backlog of Business Entity Filings and Statements of Information applications in the Business Programs Division. Of the $500,000 available under each year of the plan, $250,000 is for short-term information technology (IT) improvements to increase the functionality of the current electronic filing system and $250,000 is for staffing costs. When this two-year plan was adopted, the SOS indicated that it was intended to dovetail into a future IT project which would serve as the long-term solution to automate the Business Program Division.

Background. The SOS is responsible for the administration and enforcement of laws pertaining to filing documents associated with corporations, limited partnerships, and perfecting security agreements. On an annual basis, the SOS' Business Program Division (BPD) receives over a million business filings and requests a year. These filings by businesses are statutorily required and are not effective until reviewed and filed by the SOS. The filings and requests are comprised generally of two categories: (1) Business Filings, required of corporations, limited liability companies, and limited partnerships, which include such documents as articles of incorporation, trademarks, and other special filings; and (2) Statements of Information, which are required on an annual basis for corporations and on a biennial basis for limited liability companies, and also include common interest development association statements and publicly traded disclosure statements. Business filers are currently charged from $15-$150 dependent on the type of filing. Businesses can also pay additional fees to receive expedited service, such as $350 for 24-hour turnaround or $750 for same-day service.

The current process for accounting for and accepting these filings and requests is labor-intensive and reliant on several antiquated legacy computer systems, as well as a "paper" database (index cards) system. The SOS utilizes 23 separate Information Technology systems to support 15 of the filing types; the remaining eight filing types are essentially paper-based manual systems supported only with basic automation tools, such as Microsoft Word and Excel.

In May of 2009, the BPD had a backlog of 4,752 Business Filings with a 22-calendar day wait time; Statements of Information had a backlog of 36,737 filings with a 15-calendar day wait time. After the 2009 budget line-item veto which represented a 10 percent reduction to all constitutional offices including the SOS, and in May 2010, the Business Filings backlog had increased to 30,093 with a 72-calendar day wait time; the Statements of Information backlog had increased to 89,322 with a 52-calendar day wait time. In October of 2010, the backlogs had grown to 117-calendar days for Business Filings and 101-calendar days for Statements of Information.

As noted above, as part of the 2010-11 budget, a $1 million two-year plan was adopted to reduce the current backlogs in the BPD. As of April 11, 2011, the SOS reports that $300,000 has been spent, resulting in the processing of 94,000 Business Filings with $2.8 million in filing fees attached. This activity reduced the Business Filings backlog by over six weeks (from 117-calendar days to 72-calendar days). The funding was utilized to keep the backlog in Statements of Information relatively flat (the backlog in October 2010 was 101-calendar days; the April 2011 backlog is 111-calendar days). Progress was not made in reducing this backlog because the annual volume of filings is so large.

As of April 11, 2011, the current BPD backlog totals 200,000 documents waiting to be processed; of these, roughly 70,000 are Business Filings, with the remainder Annual Statements of Information. The SOS estimates that $3 million in uncashed checks are attached to these filings. Depending on type of filing, the current wait time is from two to four months.

The Business Connect Project is proposed as a business- or solutions-based procurement whereby vendors are provided with a business case and fundamental requirements which they then propose and submit solutions to meet the SOS' needs. Phase 1 consists of the development of the SOS' business and functional requirements which becomes the Request for Proposal (RFP) that vendors then respond to. More details about the technical solution, including a more robust estimate of project costs, will be outlined in a Special Project Report (SPR) to be filed with the California Technology Agency after vendor responses to the RFP are received. Based on the approved SPR, additional spending authority for each subsequent phase of the project will be sought from the Legislature. The SOS estimates total project costs of $23.7 million. The fund source is fees currently paid by businesses for filings and services.

Since 2006-07 and through 2009-10, both Reimbursements (expedited and special handling fees) and Business Fees Revenues (standard filing fees) have represented a GF solution totaling $23.1 million and 40.7 million, respectively. In 2010-11, it is estimated that $9.2 million in Reimbursements and $1.1 million in Business Fees Revenues will transfer to the GF. In 2011-12, it is projected that $9.0 million in Reimbursements and $432,000 in Business Fees Revenues will transfer to the GF. Figures 1 and 2 below provide further detail as to these collections and GF transfers.

Figure 1
Reimbursements Collected and Transferred to the GF (dollars in thousands)

	2006/07	2007/08	2008/09	2009/10	*2010/11 Estimated*	*2011/12 Projected*
Revenues	$13.4	$13.0	$11.4	$14.0	*$16.2*	*$16.2*
Expenditures	$7.3	$7.3	$7.3	$6.8	*$7.0*	*$7.2*
Total Excess Transferred to GF	$6.1	$5.7	$4.1	$7.2	*$9.2*	*$9.0*

Figure 2
Business Fees Fund Revenues Collected and Transferred to the GF (dollars in thousands)

	2006/07	2007/08	2008/09	2009/10	*2010/11 Estimated*	*2011/12 Projected*
Revenues	$51.0	$47.0	$44.4	$38.9	*$39.5*	*$39.5*
Expenditures	$32.4	$36.3	$35.8	$36.1	*$38.4*	*$39.1*
Total Excess Transferred to GF	$18.6	$10.7	$8.6	$2.8	*$1.1*	*$.4*

Staff Comment. The Business Connect Project has merit. The existing process is inefficient, the current legacy systems present a challenge to operate and maintain, and that the current backlog does not help the state's business climate. While the fees businesses have been paying have represented a GF solution in recent years, these fees were not paid with that intent. The SOS also estimates that the Business Connect Project, when complete, will save the state $5.6 million per year which means the costs of the project could be recouped in a fairly expedient manner.

Staff notes, however, two concerns with the proposed project. First, with regard to the fund source, as noted above the primary funding source for this project are the expedited fees paid by businesses. While a relatively stable revenue source in recent years, the majority of this revenue can be directly correlated to the length of the backlog; i.e., the larger the backlog the more likely a business will pay an expedited fee. The two-year $1 million solution adopted in 2010-11 has reduced one of the backlogs in question by nearly one-third via the expenditure of only 30 percent of the total funding appropriated. At some point, as the remaining $700,000 is expended on the two-year solution, a "tipping point" will be reached where the backlog will be low enough that businesses will no longer be paying the expedited fees at current rates of payment. This raises questions about the viability of this fund source to sustain the project's costs through its completion in 2016. Further, the "backstop" funding source, Business Fees Fund Revenues (Figure 2 above) is not much of a backstop as it has declined markedly in recent years with a 2011-12 projection of only $432,000 available for transfer (or expenditure on the Business Connect Project). This uncertainty places the GF at risk for being the true funding backstop for this project.

Second, staff notes that the current estimate of project costs is just that, an estimate, and there is not presently a level of certainty of what this project will actually cost. The FSR states the SOS conducted extensive monitoring and market research, and determined that the state with the closest system to meeting the SOS' needs was in North Carolina, yet that solution would only meet 30 to 40 percent of the SOS' needs, handles a significantly smaller volume, and has government accounting systems significantly different than California's. Therefore, the SOS reached the conclusion that a solutions-based procurement was necessary. This is a reasonable conclusion, but it translates to a level of uncertainty about costs estimates. This is not a criticism about the Business Connect Project or the materials presented by the SOS, but rather the reality of the state's process for developing this type of information technology project. Until an FSR is approved, a detailed RFP is developed, vendors bid on that RFP, which in turn drives the SPR which is submitted to the Technology Agency for its approval, a true estimate of the project's cost will not be fully known.

If the Subcommittee were to approve this request as presented it is in essence providing tacit approval for the entire Business Connect Project. Given all the factors at work, including that a true estimate of project costs is not known and there are questions about the viability of the fund source (and what impact the remaining $700,000 of the two-year solution will have on the stability of this fund source over time), providing approval of the entirety of the Business Connect Project at this juncture may be premature. Rather, in considering this request, the Subcommittee may wish to make clear it is only approving the development of the RFP, through the completion of the SPR. This would allow the Subcommittee to have at its disposal a more accurate estimate of project costs, as well as a more complete understanding of the viability of the fund source, when considering the Business Connect Project as part of a future budget cycle.

Staff Recommendation. Approve only the development of a Request for Proposal and the subsequent development of a Special Project Report for the Business Connect Project.

Vote: Staff recommendation approved by 3-0 vote.

0971 CALIFORNIA ALTERNATIVE ENERGY AND ADVANCED TRANSPORTATION AUTHORITY

Department Overview: The mission of the California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) is to promote the prompt and efficient development of energy sources which are renewable or which more efficiently utilize and conserve scarce energy resources.

January Budget Overview: The January Governor's Budget proposed total funding of $25.8 million (special funds and reimbursements) and 7.0 positions, an increase of $9.2 million and no change in positions. The year-over-year increase is primarily explained by the implementation of California Ethanol Producers Incentive Program. (See Issue 2 on the following pages for detail on this budget request).

Current Budget Status: One April Finance Letter was proposed, which is Issue #1 below.

Issue Proposed for Discussion / Vote

Issue 1 – AB 118 / California Ethanol Producers Incentive Program

Governor's Request: The Administration requests $9 million in reimbursement authority for CAEATFA to receive funds from the California Energy Commission (CEC) to perform activities related to the Alternative and Renewable Fuel and Vehicle Technology Program as authorized by AB 118 (Chapter 750, Statutes of 2007, Nunez). The specific program is the California Ethanol Producer Incentive Program (CEPIP) whereby financial assistance is provided to ethanol producers selected by CEC to develop and commercialize advanced transportation technologies that meet advanced energy goals.

Background/Detail: CAEATFA and the CEC entered into an interagency agreement that outlines the terms by which CAEATFA will assist CEC in implementing the ethanol incentive program goals. The interagency agreement is expected to have a 4-year term expiring in January 2015. The terms of the agreement allow a transfer from the CEC to CAEATFA of up to $15 million. To date, a total of $6 million has been transferred. The Governor's budget reflects a $15 million reimbursement in 2010-11 and a $9 million reimbursement in the budget year. The two-year amount requested exceeds the interagency agreement by about $9 million – CAEATFA indicates this is proposed due to uncertainty about how funds will be distributed across fiscal years, so they double-counted the $9 million.

February 10, 2011, Hearing: This issue was rejected without prejudice to allow further time for review and to consider the March 2011 AB 118 report.

Draft AB 118 Report: This year's report has been released by the CEC and states the following on the Ethanol Producers' Program:

During the administration of the CEPIP, market conditions have become increasingly unfavorable for ethanol production, particularly within California. This is due in part to near record commodity costs for corn. Given uncertain market conditions and future price projections, it is unclear whether a modest state price support program can offset the impacts of this *unprecedented change in the ethanol fuel market. As a result, the Energy Commission will reevaluate the future of the CEPIP and study the benefits from its proposed $6 million investments before making a recommendation on funding.*

Staff Comment: Given the comments in the CEC report, there are likely more cost-effective ways to expend AB 118 dollars. If the $9 million request for 2011-12 is rejected, CAEATFA and CEC can evaluate the program results for the initial $6 million and CEPIP funding could be considered again next year, if warranted.

Staff Recommendation: Deny the BCP.

Vote: On a 3-0 vote, approved a total reimbursement level of $48,000 in 2011-12, to cover the CAEATFA cost to administer the $6 million program as allocated by the California Energy Commission to the CAEATFA in 2010-11.

0840 STATE CONTROLLER'S OFFICE

Department Overview. The State Controller is the Chief Fiscal Officer of the state. The primary functions of the State Controller's Office (SCO) are to provide sound fiscal control over both receipts and disbursements of public funds; to report periodically on the financial operations and condition of both state and local government; to make certain that money due the state is collected through fair, equitable, and effective tax administration; to provide fiscal guidance to local governments; to serve as a member of numerous policy-making state boards and commissions; and, to administer the Unclaimed Property and Property Tax Postponement Programs.

Budget Overview. The January Governor's Budget provides the SCO with 1,491 authorized positions and $218.9 million ($76.5 million GF). This is an increase of two positions and $65,000.

Issues Proposed for Discussion / Vote

Issue 1 – Local Government Oversight Initiatives

April Letter Request. In an April Finance Letter, the Governor requests increased expenditure authority of $2.098 million (reimbursements) to support 16.4 existing positions to provide increased oversight of local government entities under the SCO's existing statutory authority.

Background. Generally speaking, direct state oversight of local governments is currently limited to state and federal pass-through funding. Counties receive a large share of state/federal pass-through funding to administer a number of statewide programs under state supervision, such as health and welfare. As a result, they receive direct state oversight, including SCO audits. For cities and special districts, state oversight is more limited to the few grants or allocations of state/federal pass through funding, such as Gas Tax allocations, distributed by the state. In addition, current statute provides for a more indirect oversight of local government funding using the following three elements:

1. Annual Audits. Each local government entity is required to have an annual audit performed by an independent auditor. If the local government has over $500,000 in federal expenditures, it must also have a single audit. Local governments are required to submit these audits to the SCO. The SCO can initiate a quality control review of the work papers of any auditor when there is suspicion that the work performed is inadequate.
2. Financial Transaction Reports. Statute requires the SCO to collect a report of annual financial transactions from each county, city, and special district and to publish them in reports available to the Governor, legislature, and general public. Statute further provides that, if the reports are not made in the time, form, and manner required, or if there is reason to believe a report is false, incomplete, or incorrect, the SCO shall appoint a qualified accountant to make an investigation and to obtain the information required. Statute specifies that the SCO's enforcement costs are to be reimbursed by the local government entity in question.
3. Accounting and Audit Guidelines. Uniform accounting guidelines are intended to provide local governments with the information necessary to implement and operate a common

accounting and reporting system. Currently such guidelines are only required for counties and special districts.

With regard to the Financial Transaction Reports, these reports represent the only source of available statewide financial data on local government entities. According to 2010 estimates, the SCO staff spent more than 1,100 hours annually on monitoring the submissions and collecting forfeitures (required payments to the state for failure to file the financial report with the SCO). The SCO indicates that the reports are subject to automated edits that do not necessarily identify all the issues that warrant attention. For instance, the SCO does not presently have the resources to compare these reports between years or between similar entities. In addition, the current analyses of all of the complaints that are being submitted to the SCO (since the City of Bell stories were reported last year) are being done through staff redirections. To the extent that an analysis results in a need for further investigation, additional redirections would be needed.

Staff Comment. The current approach is not working at an optimal level to protect taxpayers from waste, fraud, and abusive financial practices. Perhaps the greatest area where more could be done is with the financial transaction reports. This request would address that need by providing the resources to the SCO to investigate and prepare annual financial transaction reports for all non-filers, as well as conduct investigations of individual financial issues that indicate some information in an annual transaction report is "false, incorrect, or incomplete."

In considering this request, it is important to note that this request would effectively expand the use of the SCO's current statutory authorities to provide more comprehensive and coordinated oversight of local government financial practices. In theory, this would identify problems before they reach a critical stage. However, the SCO has not provided a detailed systematic plan for how it would execute the additional activities nor provided any detail regarding a benefit/cost assessment of additional financial monitoring. The audit plan submitted by the SCO is limited to a total of 47 non-filing cities and special districts for 2009-10. Based on this limited universe, the justification for funding the full request and 16.4 positions is unclear. Therefore, staff recommends this request be held open pending receipt of the requested information from the SCO.

Staff Recommendation: Hold open pending receipt of additional information.

Item held open.

Issue 2 – 21st Century Project: Related Language

April Letter Request. In an April Finance Letter, the Governor requests budget trailer bill language, as well as amended 2011-12 provisional budget bill language, to ensure deployment of the 21st Century Project.

Prior Subcommittee Action. On January 25, 2011, the Subcommittee approved $63.7 million ($34.2 million GF, $1.0 reimbursements, and $28.4 million special funds) to fund the 21st Century Project in 2011-12.

Background. The SCO pays approximately 249,000 employees, including state civil service, California State University and Judicial Council employees, judges, and elected officials. The

21st Century Project (Project) will replace the existing statewide human resource management systems in order to improve management processes and fulfill payroll and reporting obligations accurately and on time. The Project began in May 2004. The first deployment wave is scheduled for October 2011, comprised of 25 departments and 14,281 employees. That initial wave will be followed by three successive wave rollouts in January 2012 (50 departments and 75,841 employees); July 2012 (10 departments and 68,065 employees);and October 2012 (77 departments and 84,650 employees). The current estimated total cost (one-time and continuing) of the 21st Century Project is $303.2 million.

This request includes the following statutory changes related to the 21st Century project:

1. Amend Section 12432 of the Government Code to extend the SCO's existing authority to assess a variety of state funds to support the completion of the 21st Century Project. Existing law would repeal this provision on June 30, 2011. The proposed budget trailer bill language would extend the date until June 30, 2014, a date consistent with the completion of the project.
2. Amend Section 3527 of the Government Code to include a limited number of positions in the SCO's Information Systems Division (ISD), and incoming staff transfers from the 21st Century Project to the ISD, to receive and/or continue their "excluded" designation following the successful deployment of the 21st Century Project.
3. Amend Section 12420.1 of the Government Code to limit the SCO's responsibilities related to establishing employee-requested deductions for the purpose of purchasing savings bonds through the Federal Treasury Direct Program with the deployment of the 21st Century Project.

The request also includes modification of existing provisional budget bill language to allow for additional 21st Century Project funding of up to $5 million in a current fiscal year due to unforeseen circumstances and if required to ensure the successful deployment of the system. The modified language does not alter an existing requirement that the Legislature be notified in writing 30 days in advance of any adjustment being made.

Staff Comment. Budget trailer bill language is the implementing language of the California State Budget Bill. While the 21st Century Project has been, and will continue to be, funded in the annual budget act, except for the amendments to Section 12432 of the Government Code, staff has been unable to identify a direct connection between the 2011-12 budget and the other two requested amendments.

The modified provisional budget bill language is intended to address unforeseen circumstances that could arise as the 21st Century Project reaches the final stages of implementation. It provides a limit and some transparency through existing legislative notification requirements; however, there are no criteria included to indicate when such an adjustment could occur or why the SCO needs such delegated authority at this time. In addition, this modified language would set the precedent of permitting an IT project to spend up to $5 million more than its approved budget or project documents without going through some form of a budget, bill, or deficiency process. Therefore, while staff recommends adopting the modified language it would be only with a lower cap of $2 million and with supplemental report language requiring the DOF and Technology Agency, in consultation with the LAO, to develop written criteria regarding the use of this authority in the future and implement the criteria prior to the commencement of the 2012-13 budget process.

Staff Recommendation: (1) Approve the modified provisional budget bill language but with a $2 million limit and placeholder supplemental report language; (2) Approve the proposed trailer bill language amending Government Code Section 12432; and (3) Deny without prejudice the remaining proposed budget trailer bill language with direction that those changes be pursued in a policy bill.

Vote: Staff recommendation approved by 3-0 vote.

2320 DEPARTMENT OF REAL ESTATE

Department Overview. A primary objective of the Department of Real Estate (DRE) is to protect the public in real estate transactions and provide licensing, regulatory, and subdivision services to the real estate industries. The DRE is entirely special funded (Real Estate Fund) and derives its revenues from examination, license, and subdivision fees. The core functions of the DRE are to administer license examinations, issue real estate licenses, regulate real estate licensees, and qualify subdivision offerings.

Budget Overview. The January Governor's Budget provides DRE with 381 authorized positions and $46.0 million (RE Fund and reimbursements). This is an increase of two positions and $1.5 million.

Issue Proposed for Discussion / Vote

Issue 1 – Sacramento Headquarters and Examination Center Consolidation and Relocation

April Letter Request. In an April Finance Letter, the Governor requests increased expenditure authority of $2.612 million (Real Estate Fund) to relocate and consolidate into one location on or about January 1, 2012, the DRE's Sacramento Headquarters Office and Examination Center. Figure 3 below summarizes the components of this request:

Figure 3

	2011-12	2012-13	2013-14
Six months rent increase January 1 through June 30, 2012	$635,500*		
Moving related expenses	$1,220,000*		
Tenant Improvements	$756,000*		
Increased rent costs for twelve months (July 1, 2012, through June 30, 2013)		$1,271,000	
Six months of scheduled lease cost increase ($.07 per square foot of office space)		$31,500	
Ongoing lease cost increases over term of lease			$63,000
TOTAL	$2,611,500*	$1,302,500	$63,000**

*2011-12 costs are all one-time.
**Increased amount continues through Fiscal Year 2019-20.

Prior Subcommittee Action. As part of the 2009-10 budget, the Governor requested a one-time augmentation of $1 million (Real Estate Fund) to partially cover the estimated costs ($1.3-$1.5 million) to relocate and consolidate the DRE's downtown Sacramento Headquarters Office and Examination Center at a new location. At that time, staff did not necessarily dispute DRE's claim that the existing facilities did not meet the long-term needs of the department and once increased rent and the cost of a double move were factored in. However, the Subcommittee rejected the request due to the fact that the Real Estate Fund had a structural deficit.

As part of the 2010-11 budget, the DRE did not present a request related to its Headquarters relocation and consolidation; rather, the DRE proposed to absorb those costs from within its existing budget. The Subcommittee did not agree with this approach, due to concerns that doing so could result in decreased enforcement and consumer protection activities. The Subcommittee instead requested that the DRE present a formal request related to its facility needs during the 2011-12 budget process.

Background. The DRE's Headquarters and Examination Center facilities have been located in their present locations in downtown Sacramento since 1985. The DRE leases a total of 44,922 square feet at a cost of $1.75 per square feet. The current lease expires on September 30, 2011, and will thereafter convert to a month-to-month soft-term lease agreement. The amount of leased space has not changed during the 26 years the DRE has been at this location; therefore, the current facilities present significant space constraints. Since 1985, the DRE's licensee population and the associated workload and file storage requirements have increased by 70 percent; there were 268,842 licensees in 1985, and a total of 457,113 today. In addition, the DRE was recently required to add a new licensing and enforcement program for mortgage loan originators. The DRE has also absorbed a 38 percent increase in staff levels, from 144 staff in January 1987 (accurate earlier data unavailable) to a total of 198 today. In addition, the current facilities present significant health and safety concerns and deterioration problems. The DRE also cannot offer electronic license examinations in the current exam center without extensive renovations and costs; current estimates are that the costs could approach $900,000 based on renovations of similar exam facilities.

Working with the DGS' Real Estate Leasing and Planning Section, the DRE is considering several new locations within the City of Sacramento, as required by current law. The request before the Subcommittee represents a new facility comprised of a total of 75,000 square feet of office space at an estimated cost of $2.40 per square foot and 10,000 square feet of warehouse space at an estimated cost of $.45 per square foot, for a total estimated lease cost of $2.214 million per year. The DRE is presently paying $943,000 per year for its current facilities; the new location would therefore represent a net increase of $1.271 million per year in lease costs. The DGS is proposing a lease term of eight years, with the first four years termed "firm," and the second four years termed "soft." According to DGS, the eight year lease is a state product and has been in use for about ten years.

The one-time moving costs are estimated to total $1.22 million, including: (1) $990,000 for Modular Systems Furniture; (2) $115,000 in moving expenses; (3) $46,000 to install telecommunications systems; (4) $46,000 for network switches, cabling, and electrical costs; and (5) $23,000 for supplies such as business cards, stationary, etc.

Staff Comment. Staff concurs with the need to relocate and consolidate the DRE's Sacramento Headquarters and Examination Center facilities into a single location, thereby achieving a more efficient operation and a safer working environment, for both employees, licensees, and the general public. Remaining in the current location is not an option, neither is renovating the current facility as that option would require costly improvements and do nothing to address the fact that the DRE has simply outgrown its current space. This latter option would also involve double moving costs.

Staff notes that this request is built upon estimated lease costs of $2.40 per square foot for office space and $.45 per square foot of warehouse space. The DGS has indicated, however, that given current conditions in the commercial real estate market it is likely that DRE's office lease costs will result in a final cost of $2.00 per square foot, with a similar level of reduction in warehouse lease costs. Therefore, in considering this request, the Subcommittee may wish to adopt provisional budget bill language to ensure that any unused funds appropriated in 2011-12 for lease terms are not built into the DRE’s base budget.

Staff Recommendation: Approve the request and adopt placeholder provisional budget bill language to state that the DRE cannot redirect amounts in excess of agreed-upon relocation and consolidation costs, including lease terms, to other purposes.

Vote: Staff recommendation approved by 3-0 vote.

8955 CALIFORNIA DEPARTMENT OF VETERANS AFFAIRS

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

Budget Overview. The January Governor's Budget proposes to continue to ramp-up admissions at the VHCs in West Los Angeles, Lancaster, and Ventura. The Governor also proposes to provide continued resources and staffing related to the construction and activation of two new VHCs, in Redding and Fresno, both of which are scheduled to begin admissions in early calendar year 2012. The January Governor's Budget provides CDVA with 2,396.5 authorized positions and $399.3 million ($253.4 million GF).

Issue Proposed for Discussion / Vote

Issue 1 – Central Coast Veterans Cemetery Project: Preliminary Plans

April Letter Request. In an April Finance Letter, the Governor requests that two new items be added to the 2011-12 budget to transfer and then appropriate $1.074 million for the preliminary plans phase of the Central Coast Veterans Cemetery project.

Background. Military and Veterans Code Section 1450 et seq. required the CDVA to develop a master plan for a Central Coast Veterans Cemetery Project, a state-owned and operated veterans' cemetery on the grounds of the former Fort Ord in Monterey County. To fund the Cemetery Project, the original 2000 statute provided $140,000 GF seed money for the master plan and created two funds: (1) the California Central Coast State Veterans Cemetery at Fort Ord Endowment Fund (Endowment Fund); and (2) the California Central Coast State Veterans Cemetery at Fort Ord Operations Fund (Operations Fund). The Endowment fund is the mechanism for local entities to provide funding for the development and operation of the Cemetery Project. The Operations Fund receives its funding via transfer from the Endowment Fund to support the costs of designing, constructing, and maintaining the Cemetery Project. To protect the state, and before a transfer can be made, statute requires a Director of Finance determination that adequate funds exist in the Endowment Fund to fully complete the preliminary plans (as well as working drawings).

Per the master plan, the Cemetery Project would utilize a portion of a 79-acre site and accommodate the remains of nearly 14,000 veterans and spouses. It is expected that the Cemetery Project would accommodate anticipated burials for the next 20 years and that the full 79-acre site, once eventually developed, is adequate to meet burial demand for the next 100 years. The total Cemetery Project costs of $27.0 million would be funded through a mixture of local moneys transferred into the Endowment Fund and federal funds, with the federal funds providing all of the construction costs and reimbursement of most of the design costs.

The April letter before the Subcommittee would add item 8955-011-0848 to the 2011-12 budget to transfer $1.074 million from the Endowment Fund to the Operations Fund. In addition, the April letter requests that item 8955-301-3013 be added to the 2011-12 budget to appropriate $1.074 million from the Operations Fund for the preliminary plans phase of the Cemetery Project.

Statute also requires the State Controller's Office to annually report the amount of interest and investment earnings generated by the Endowment Fund and the estimated amount of additional principal needed to generate annual interest revenue that will sufficiently fund the estimated annual administrative and oversight costs. The most recent report, dated July 22, 2010, reported that no deposits were made to the Endowment Fund and the fund remained with a zero cash balance for the fiscal year ended June 30, 2010, and prior. Therefore, no interest or investment earnings were generated.

Staff Comment. This April letter requests to add items to the budget to transfer nonexistent funds from an Endowment Fund to an Operations Fund and then appropriate those nonexistent funds to cover the costs of preliminary plans for the Central Coast Veterans Cemetery Project. When queried on this approach, the Administration indicated that while it is not commonly utilized its purpose is to show good faith on the part of the state with the local entities that support and are raising funds for the Cemetery Project. The local entities presently fear that if they deposit funds raised (currently $160,000) into the Endowment Fund they have no assurance that the state will then in turn appropriate the funds for preliminary plans, which is the first phase or step to realizing the Cemetery Project. Given the state's fiscal condition, this fear is understandable, and has also potentially impacted the local entities' ability to raise funds. Were this request to be approved, local entities could therefore have an enhanced ability to raise funds as they have "proof" of the state's intent to support the Cemetery Project.

According to the Administration, this approach was used in the 2001-01 budget to authorize a predominantly privately funded project to renovate and expand the Lincoln Theater at the Veterans Home of California Yountville prior to the private funds being in place. More recently, the 2010-11 budget includes three Department of Parks and Recreation projects that are to be funded by private non-profits. In this case, the funds were not set-aside at the time of appropriation, which is why Provision 2 was added to state, "*The funds in this item shall not be expended without prior approval from the Department of Finance*."

As noted in the background section above, current statute contains checks and balances to prevent moving forward on the preliminary plans without the total required funding being deposited into the Endowment Fund. Further, current statute delineates a process whereby the subsequent phases of the Cemetery Project (i.e., working drawings and construction) will proceed only when funds are available as determined by the Director of Finance. This April letter is limited to the first phase – preliminary plans. Therefore, in considering this request, the Subcommittee may wish to modify the Administration's budget bill language to include a citation to the relevant statute.

Staff Recommendation: Approve the April letter with modified budget bill language citing the relevant Military and Veterans Code statute.

Vote: Staff recommendation approved by 3-0 vote.