

SUBCOMMITTEE NO. 4

Agenda

Senator Richard D. Roth, Chair
Senator Steven M. Glazer
Senator Janet Nguyen
Senator Richard Pan



Thursday, April 7, 2016
9:30 a.m. or Upon Adjournment of Session
State Capitol - Rose Ann Vuich Hearing Room 2040

Consultant: Mark Ibele

PART A

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ISSUES PROPOSED FOR VOTE ONLY

0840 STATE CONTROLLER'S OFFICE

Issue 1: Sustained Accounting Workload (BCP 013)

Governor's Proposal. The State Controller's Office (SCO) requests \$221,000 (\$126,000 General Fund) in 2016-17 and ongoing for two positions (extending current expiring positions) to enable the SCO Division of Accounting and Reporting's (DAR) Cash Management Bureau to continue state-wide cash management services.

Background. Prior to July of 2008, the SCO had been able to effectively manage the state's cash with five staff in the Cash Management Forecasting and Reconciliation Section (CMS). In response to the increased workload resulting from the downturn in the California and national economies, the workload associated with managing the state's cash and ensuring timely payment of the state's obligations increased significantly. In 2008-09, CMS received one additional permanent position; however, as the state's cash crisis continued through 2011-12, excessive hours of overtime were required to complete mandatory cash management activities. In addition, as a result of the increased focus in monitoring cash during this time, several accounting and reconciling activities experienced backlogs. To address the overtime and the backlogs caused by the increased cash management activities, the SCO received funding for two limited-term positions approved for 2010-11, 2012-13, and 2014-15, which temporarily increased the CMS's resources to eight positions through 2015-16. These resources have been deployed to automate processes, update procedures and train staff on critical functions.

Staff Comment. The requested resources will ensure that CMS is able to continue performing effective analyses of payment obligations, borrowable resources and cash flow forecasting. Making these positions permanent instead of relying on limited-term resources will reduce the turnover and retain the knowledge necessary to provide important information to decision-makers and improve necessary cash management measures into the next recession. Retaining these positions is a prudent means of assuring adequate resources for potential future periods of fiscal stress and cash shortfalls.

Staff Recommendation. Approve as budgeted.

Vote.

Issue 2: Personnel and Payroll Transactions Workload (BCP 008)

Governor's Proposal. In the Governor's budget, the State Controller's Office (SCO) requests \$325,000 (\$186,000 General Fund) in 2016-17 and \$287,000 (\$164,000 General Fund) in 2017-18, and ongoing, for four positions to improve the current 46 percent call center answer rate, and dedicate additional staff time to the completion of production work.

Background. The Personnel and Payroll Services Division (PPSD) administers the state's Uniform State Payroll System (USPS) and audits and processes all personnel and payroll transactions for state civil service and exempt employees and the California State University (CSU) system. The PPSD provides information required to manage the personnel resources of the state, accounts for salary and wage expenditures, and provides data to the retirement systems necessary for calculation of employee retirement benefits. PPSD personnel are responsible for providing answers to department and CSU human resource offices, as well as other interested parties, and for processing transactions to ensure employees are paid correctly. Various state offices contact the department seeking clarification or instruction on how to process personnel or payroll transactions and/or properly fill-out documents required for SCO processing. The majority of calls are made to a single telephone number and then routed by an automatic call distribution system to specific business areas. Staff in each business area split the workload of processing transactions, answering phone calls and responding to email inquiries. Errors can result in either time lags and/or incorrect pay for employees. Existing staff resources are insufficient with the majority of calls being routed to voicemail or being abandoned entirely. From 2012-13 through 2014-15, only 46 percent of calls were answered, 38 percent went to voicemail and 16 percent were abandoned. Unaddressed calls and queries can lead to errors, inefficiencies and more costly intervention at a later date.

Staff Comments. The SCO notes that because department and CSU human resources offices may not receive the appropriate level of assistance, they often escalate calls that they feel require immediate attention and lead to overall increases in staffing costs. The requested resources are expected to improve responses to department and CSU human resource office inquiries, such that up to 64 percent of initial calls will be answered, instead of the current rate of 46 percent. Staff will also be available for work on processing documents, decreasing the turn-around time for payroll and personnel transactions.

Staff Recommendation. Approve as budgeted.

Vote.

Issue 3: Personnel and Payroll Services Division Systems Support (BCP 018)

Governor's Proposal. The proposed budget includes State Controller's Office (SCO) requests for \$1.1 million (General Fund) in 2016-17, and \$1.0 million (General Fund) 2017-18 and 2018-19 for 7.9 positions to support payroll and personnel mainframe-based systems known as the Uniform State Payroll System (USPS). The positions will be assigned primarily to application development (4.9 positions) with one position each for database management, information security administration and project management.

Background. Until 2012-13, the SCO was in the process of developing a new integrated payroll system, referred to as the 21st Century Project, to replace existing legacy systems. During the development phases of the project, many new laws affecting the payroll system were handled through short term alternative workarounds. System enhancements that would increase the efficiency of the Personnel and Payroll Services Division (PPSD) business processes were also suspended. In February 2012, the 21st Century Project was suspended, requiring the SCO to revert to its existing mainframe systems. Upon reversion to the legacy systems, information systems division (ISD) staff began developing and implementing several deferred maintenance service requests. Currently, PPSD has identified and prioritized approximately 30 requests that are considered backlogged mandated work. ISD has completed a high-level analysis of these backlogged requests and identified 28 requests requiring application development work. The desired outcome is that ISD will support the maintenance and operations needs of the PPSD and their mainframe-based application systems, as well as reduce the service request backlog.

Staff Comment. The SCO notes that ISD staffing on mainframe development resources is at a historical low, and is further declining due to an aging workforce. A lack of skilled, knowledgeable resources can impact critical software upgrades, system testing, disaster recovery, operational support and security management, resulting in instability and vulnerability of the USPS. ISD is also faced with conflicting responsibilities of needing to work on maintenance and operations activities, the service request backlogs, as well as other high priority requests. The termination of the 21st Century Project is largely the catalyst for the request to backfill delayed maintenance and improvements in the legacy systems.

Staff Recommendation. Approve as budgeted.

Vote.

ITEMS FOR DISCUSSION AND VOTE

0840 STATE CONTROLLER'S OFFICE

Presenter: Betty Yee, California State Controller

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

Budget Overview. The department receives about 32 percent of its annual budget from reimbursements, 25 percent from the General Fund, 21 percent from the Unclaimed Property Fund, about 13 percent from the Central Service Cost Recovery Fund, and the remainder from various special funds. The funding structure is based on the SCO's statewide responsibilities that cut across all funds and programs.

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

Program	Actual 2014-15	Estimated 2015-16	Proposed 2016-17
Accounting and Reporting	\$39,392	\$43,693	\$44,905
Audits	44,955	44,078	48,674
Personnel and Payroll	50,140	51,417	42,352
Unclaimed Property	38,496	38,312	38,690
Disbursements	27,222	28,153	25,616
Net Other	397	669	277
Total Expenditures	\$200,602	\$206,322	\$200,514

**State Controller's Office
Position Authority
(actual positions)**

Program	Actual 2014-15	Estimated 2015-16	Proposed 2016-17
Accounting and Reporting	280.4	252.0	264.7
Audits	312.5	297.9	302.2
Personnel and Payroll	220.6	209.0	216.5
Unclaimed Property	244.2	261.4	261.4
Disbursements	84.3	95.8	95.8
Administration	282.2	282.7	299.8
Total Positions	1,424.2	1,398.8	1,440.4

Issue 1: 21st Century Project Legal Efforts (BCP 001, BCP 019, CS 25.25, BBL and TBL)

Governor's Proposal. The Governor's proposal regarding this item includes a budget resource request, budget bill language (BBL) and trailer bill language (TBL). The State Controller's Office (SCO) requests \$4.8 million (\$3.8 million special funds and \$1.0 million reimbursements) in 2016-17 for one-year limited-term funding to support eight positions for six months for ongoing legal activities stemming from the 21st Century Project. In addition, maintenance of the MyCalPAYS (MCP) payroll system is required to pursue the state's legal claim for the losses incurred, and that will be incurred due to the vendor's abandonment of its contractual obligation to produce the MCP system.

The BBL in Provision 14 of Item 0840 addresses the ability of the Department of Finance (DOF) to augment amounts in Control Section (CS) 25.25, where the budget appropriation is contained. The ability of DOF to augment is without a specified amount and requires 30 day notification be provided to the Chair of the Joint Legislative Budget Committee. The proposed TBL extends the authorization for the 21st Century Project by one year, from June 30, 2016 to June 30, 2017.

Background. This item addresses the legal costs associated with the termination of the contract associated with the implementation of the 21st Century Project. The termination of the contract occurred after numerous apparent failures by the contractor SAP to perform under contract and the failure of the mediation process. After it became clear that the mediation process was at an impasse, the contract was terminated and the SCO filed a lawsuit against SAP for breach of contract. SAP subsequently countersued. The state has not achieved the benefits envisioned of the new system and has reverted to using its legacy systems. The value of the investment and whether any aspects of the project can be used in the future are uncertain. The SCO indicates that as result of SAP's breaches of the contract, the state has suffered losses of the amount already paid to SAP, as well as expenses incurred in addressing state needs in the absence of the system SAP was to deliver.

In order to address its costs, the SCO received eight positions through the 2015 Budget Act to fund legal and related activities. This funding will expire on June 30, 2016, but it is anticipated

that continued support will be required into 2016-17. Continued legal cost increases are due to the following (attributable primarily to SAP): extended deposition schedule; expanded scope of deponents to other state officials and third parties; increased number of depositions; rise in costs of preparing for and taking depositions; expanded public records act (PRA) discovery; increased document volumes; and, delayed delivery of critical documentation. The legal team is focused on deposing SAP personnel and defending depositions of state staff involved with the project as well as reviewing project artifacts and SAP documents not provided to the SCO during the project. From October 2015 through May 2016, the legal team will prepare the case for trial, which is scheduled for May 23, 2016.

Staff Comments. The legal proceedings with SCO and SAP are at the final stage, and additional resources to protect the state's financial interest in the concluding proceedings are warranted. Should the state not pursue its remedies, including recovery of the amounts due under the contract, SAP may prevail in its countersuit against the state by claiming the state's contract termination was for convenience instead of cause. A termination for convenience is not justified given SAP's actions and would potentially cost the state tens of millions of dollars under the contract. Should the state prevail, the contract provides the state with the ability to recover up to 1.5 times the contract amount, or up to approximately \$156 million. The time extension given in the TBL will allow the legal process to continue. The BBL is unnecessary given that the legal phase is expected to terminate by the end of calendar year 2016. In addition, if unanticipated costs arise, there are alternative means available for augmenting legal expenses, under Item 9840.

Staff Recommendation. Approve the budget request as proposed and adopt the TBL extending the project date. Reject the provisional BBL.

Vote.

Issue 2: Statewide Personnel and Payroll Training (BCP 006, BCP 007)

Governor's Proposal. In the Governor's budget, the State Controller's Office (SCO) requests \$307,000 (\$175,000 General Fund) in 2016-17 and \$235,000 (\$134,000 General Fund) in 2017-18 to support 2.1 positions; and \$769,000 (\$380,000 General Fund) in 2016-17 and \$763,000 (\$377,000 General Fund) in 2017-18 and ongoing to support 7.4 positions to continue to meet ongoing needs for statewide personnel and payroll training. The remainder of the cost is borne by the Central Service Cost Recovery Fund (CSCRF) or reimbursements.

Background. The Personnel and Payroll Services Division (PPSD) of the SCO is responsible for issuing pay to employees of the state civil service, California State University (CSU) and Judicial Council utilizing the State Controller's Uniform State Payroll System (USPS). Currently over 150 departments and 24 CSU campuses serve the State of California. The state workforce is comprised of approximately 284,000 employees, represented by 21 state civil service bargaining units and 13 CSU bargaining units. Employees are located throughout California and in other states, and range from elected officials, managers and supervisors, and higher education faculty, to rank and file workers in various occupations.

The Statewide Training Unit (STU) within PPSD was created with the goal of providing personnel/payroll training to human resources staff in all civil service state departments at no-cost for those receiving training. The training courses are intended to provide human resources staff with the essential knowledge, skills and abilities to accurately process personnel/payroll transactions (e.g. appointments, separations, overtime, pay differentials) and generate accurate and timely payroll using the USPS. The demand for statewide training classes has exceeded the number of classes that can be offered with existing resources. While the proportion of training needs served has increased, the SCO is still short of the necessary resources to address the demand. The percent of training needs met (based on requests fulfilled) has grown from around 40 percent in 2013 and 2014 to 50.8 percent in 2015. The requested resources and positions will allow this to increase to address about two-thirds of training requests by 2017. Training approaches undertaken by the department includes classroom training, eTraining, and Train-the-Trainer.

Staff Comments. The department has adequately documented the workload associated with training requests. In addition, it has provided examples of costs incurred by the state when adequate training has not been provided. For example, in the *State Auditor's High Risk Update Report* (2014), the auditor noted 197,000 hours of unearned leave was inaccurately credited to employees at a state cost of \$6.4 million. While it is not apparent that additional training would have corrected any malfeasance associated with this over-crediting, certainly it could have mitigated any losses due to inadvertent actions. The committee may wish to request department to explain the long-term training requirements and how these will be addressed with the end of the limited-term funding.

Staff Recommendation. Approve as budgeted.

Vote.

Issue 3: ACA and PEPRAs Legislation Workload (BCP 005)

Governor's Proposal. The Governor's budget proposes additional resources to comply with two major pieces of legislation - the Federal Patient Protection and Affordable Care Act (ACA) and the California Public Employees' Pension Reform Act (PEPRA). The State Controller's Office (SCO) requests \$1.0 million (\$548,000 General Fund) in 2016-17, and \$927,000 (\$528,000 General Fund) in 2017-18, for 8.4 positions (3.2 continuing and 5.2 new) to support the continuing impact of major changes to the SCO's Uniform State Payroll System (USPS), the Affordable Care Act Database System (ACAS), and associated business processes as a result of requirements mandated by state and federal legislation.

Background. In 2012, California enacted pension reform legislation known as PEPRA. The Department of Human Resources (CalHR) issued a formal request to the SCO to implement the PEPRA requirements for employee retirement contribution rate changes, beginning July 1, 2013. Due to the multifaceted nature of the PEPRA legislation, the California Public Employees Retirement System (CalPERS) has not been able to determine or publish comprehensive

guidelines on the full impact of PEPRA to date and, as a result, analyzes and interprets PEPRA's impact on a flow basis through the issuance of circular letters. As CalPERS determines the full impacts of PEPRA, the SCO (among other entities) must conduct analyses to determine what impact these changes have on the programs within their scope of responsibility. The SCO indicates that implementing the system changes to support PEPRA are complex and time-consuming, requiring SCO staff to analyze and identify impacts to current processes and programs and coordinate those changes with the USPS and other downstream programs and processes. Continuous monitoring of the technology systems and frequent dissemination and communication is required to ensure ongoing system accuracy and minimal impact to payroll and employment status operations.

In 2014-15, the SCO received 1.5 two-year limited-term positions to support PEPRA workloads. Along with the 1.5 positions, PPSD redirected four positions in 2014-15 and made significant business process and system changes to the USPS as the result of PEPRA, including instituting new retirement account codes, eliminating the employer paid monthly contribution for certain bargaining units, implementing a pensionable compensation cap for PEPRA employees with a manual process to refund/adjust retirement contributions, developing processes to track reciprocity for PEPRA employees and to identify PEPRA members for the California Teachers Retirement System (CalSTRS), placing prohibitions on replacement benefit plans for new PEPRA members, and creating new processes for determining reportable compensation and other activities.

The ACA, signed into law in March 2010, also represents a challenge in implementation and administration. Initially complex as proposed, several sections of the law were amended in subsequent years, complicating matters further. In June 2012, the U.S. Supreme Court upheld the law and made the reporting requirements optional for all employers in the 2012 tax year with portions of the mandated requirements starting in the 2013 tax year. In July 2013, the federal government issued a notice acknowledging the complexity of the legislation and its role in various delays, including establishing regulations for the implementation employer and insurer reporting requirements for all medium and large employers, such as the state. Such rules are necessary to determine any tax penalties imposed if such employers do not offer and document affordable health coverage to employees. Implementation of the employer mandate provisions were extended to January 1, 2015, and the mandated reporting requirements until January 1, 2016.

The reporting requirements that are scheduled to be implemented as of January 1, 2016 will be used by the federal government as a means of ensuring that employers comply with the ACA requirements for offering health coverage. SCO will play the primary role in generating and providing reports for the state, as an employer. Failure to report in a timely and accurate manner may result in additional financial penalties to the state. To implement the employer shared responsibility provisions of the ACA and provide the required reporting, the SCO determined that the state needs to collect data that was not currently available in the USPS or other automated systems. The SCO initiated efforts to collect the required data beginning January 1, 2015. In 2014-15, the SCO received 1.5 two-year limited-term positions to support these ACA workloads. Along with the 1.5 positions, PPSD redirected 11.6 positions in 2014-15 and

designed and implemented a data collection and reporting system currently being used by 1,661 users statewide.

The workload generated by PEPRA will continue in 2015-16, and beyond. The SCO anticipates making the following significant business process and/or system changes to the USPS beginning in 2015-16, and continuing into future years. These changes are either new as the result of PEPRA or are now more complex due to PEPRA, and include: continuing to analyze and make coding changes to reflect decisions made regarding pensionable compensation; creating new retirement account codes to identify new PEPRA members; moving PEPRA employees to new account codes once they are created; analyzing, designing, building, testing and implementing a process to automate the identification of employees as new PEPRA or existing members; analyzing, designing, building, testing and implementing a process to automate contribution limits to cap the employer and employee share of retirement contributions.

The greater than previously anticipated workload generated by the ACA will continue in 2015-16, and beyond. SCO now has both a support and maintenance responsibility for the ACAS, as well as a project analysis, development and implementation responsibility related to new ACA provisions and reporting requirements. Therefore, the SCO is required to expend increased resources to support both of these functions simultaneously. Currently, the SCO has the following broad responsibilities in relation to the ACA: maintaining the ACAS and providing customer support to the 1,661 statewide ACAS users; implementing the ACA compliance program in conjunction with CalHR; implementing the monthly process to receive ACA data from the 53 entities that are not in the USPS; assisting CalHR with calculating and monitoring the monthly and annual ACA "safe harbor" by developing monthly and annual reports to monitor and mitigate potential financial penalties; developing and implementing the annual IRS reports and employee statements as well as the monthly correction reports to the IRS to reflect changes and/or retroactive transactions processed by departments/campuses; and beginning analysis on the impacts of the ACA provisions regarding the "Cadillac tax" to the state and its health plans to identify changes to the USPS, the ACAS, business processes and reports.

To achieve these responsibilities, the SCO anticipates making several significant business process and system changes to the ACAS, the USPS and related business processes as the result of ACA in 2015-16 and in future years. The affected units must complete work in each of the following key areas:

- Business process development and review.
- Business requirements for system modifications and updates.
- System support and testing.
- Customer service support.
- Training.
- Project analysis and support.

Staff Comments: The SCO indicates that noncompliance with the ACA risks the imposition of substantial federal penalties, potentially in the range of \$350-\$450 million annually. As the budget request notes, PEPRA and the ACA are complex pieces of legislation with significant multi-year impacts on the state. In many cases, different aspects of the legislation are phased in over time, leading to multi-year impacts to SCO's workload. To date, the SCO has received 3.2

two-year limited-term positions for 2014-15 and 2015-16 to address the PEPRA and ACA workload; however, to meet legally-mandated requirements and timelines, the SCO had to expend 18.6 position resources in 2014-15, which exceeded the resources received. The proposal would address that shortfall.

Staff Recommendation. Approve as budgeted.

Vote.

Issue 4: Financial Information System for California System Support (BCP 016)

Governor's Proposal. The Governor's budget includes a request from the State Controller's Office (SCO) for \$1.7 million (\$968,000 General Fund) in 2016-17, and \$1.6 (\$911,000 General Fund) in 2017-18 and 2018-19 for 13.0 positions to support new workload resulting from the FI\$Cal project. The requested resources are intended to provide for the SCO's continued efforts to fulfill its obligations and statutory responsibilities related to fiscal management, state reporting and auditing of payments during transition and use of the FI\$Cal system. The positions will be directed to governance risk and compliance (eight positions), business analysis (two positions), information security (one position), production operations (one position), application development (four positions).

Background. The SCO in partnership with Department of Finance, State Treasurer's Office and the Department of General Services are engaged in a collaborative effort to develop, implement, utilize and maintain an integrated financial management system, known as the FI\$Cal project. As described elsewhere in this agenda, the FI\$Cal system is a statewide enterprise solution, which will re-engineer the state's business processes and encompass the management of resources and dollars in the areas of budgeting, accounting, procurement, cash management, financial management, financial reporting, cost accounting, asset management, project accounting, grant management and human resources management.

Within these areas, each partner agency maintains 'ownership' of its respective business processes as it relates to their constitutional and/or statutory responsibilities. The FI\$Cal system is a custom, off-the-shelf enterprise resource planning tool to be implemented in waves (and recently re-designated as 'releases'). Currently, the FI\$Cal project has deployed Waves 1 and 2, with the most recent deployment occurring in December 2015. The workload and associated resources requested within this BCP are based upon a revised project timeline for the Releases 3 and 4 as identified within the FI\$Cal Project SPR 6. It is expected that SCO control agency functionality in Release 3 will not be deployed until July 2017. It is also expected that Release 4 will not be released until July 2018. While previous waves have introduced new workloads within the Information Systems Division (ISD), the next releases are expected to have a critical bearing and significant impact in ISD's ability to not only maintain and support the existing financial systems, but also create the need to develop, build and implement the required functionality to support the FI\$Cal system on an interim basis until it is fully deployed.

Additionally, there are approximately 18 agencies slated as deferred or exempt from the FISCAL system. Until an implementation plan is provided by the FISCAL project for these agencies, the existing financial systems will need to remain operational and the decommissioning timeline cannot be determined. At this time, the FISCAL project has not identified all of the financial sub-systems which are not migrating to the new FISCAL system. These actions are necessary to ensure both the SCO financial systems and the new FISCAL system provide the same services, data, and security for those departments not migrating to the FISCAL system. These responsibilities directly affect the existing and new systems, with respect to availability, security, performance, data integrity, and capacity, as well as various upstream and downstream components. In addition, the SCO has critical responsibilities to support home divisions as it relates to statewide interfaces, security and governance risk and compliance in the near term.

Staff Comments. The positions in this request appear to be necessary to support required activities for the SCO in the areas of security, compliance, analysis and ISD support. These resources will be integrated into existing SCO divisions and report to SCO management. The workload and resources requested are in direct support of both the SCO and FISCAL, and will demonstrate a commitment to the success of the FISCAL project beyond implementation. Given that direct requests related to the FISCAL project and department have not yet been acted upon by the committee, the item should be held open, pending final action on those items.

Staff Recommendation. Hold open.

Vote.

Issue 5: Unclaimed Property Fraudulent Claims Prevention and Detection Program (BCP 004)

Governor's Proposal. The State Controller's Office (SCO) requests \$1.0 million (Unclaimed Property Fund) in 2016-17 through 2018-19 for nine positions, and \$1.4 million (Unclaimed Property Fund) in permanent funding for eight positions in 2016-17, and ongoing. The resources will allow for the continued support of the SCO's unclaimed property fraudulent claims prevention and detection program. Approval of these resources will allow the SCO to continue the program that was initiated three years ago.

Background. The SCO is responsible for safeguarding unclaimed property until it is returned to its rightful owner. The Unclaimed Property Division (UPD) of the SCO reunites owners with their lost or abandoned property when the owner files a paper claim following a search for property on the SCO's website or after calling the UPD call center to request a claim form. Claims are also generated from owners receiving a notice from the UPD. In each case, the claimant must fill out and return a claim form with documentation of their identity and other validation that he/she is the rightful owner of the property. Claims may be filed by various individuals, including the purported owner of the property reported by the holder, the heir of the owner reported by the holder, or an agent filing on behalf of a business reported by the holder. When information reported by holders on properties is incomplete, staff is required to contact the

holder to obtain additional information. In some instances, holders (often banks or other financial institutions) have purged information due to the age of accounts.

The SCO is requesting resources to continue the work of preventing fraudulent unclaimed property claims from being paid. For 2012-13, the SCO received 17.9 positions for the fraud program on a two-year limited-term basis to address the increase in fraudulent claims received by the UPD. To continue the SCO's efforts in mitigating fraudulent claims, the Legislature authorized 16.0 positions in 2014-15 for the fraud program for another two-year limited-term. In the budget, the SCO is requesting resources to continue the current level of work in the fraud program. The current request would, for the three-year period, allow a steady number of claims to be reviewed (about 16,000 annually) representing a dollar value of about \$24 million

Since the start of the fraud program, the UPD has identified over \$28 million in fraudulent claims. The fraud unit has reviewed 39,878 claims, of which 1,606 were identified as fraudulent, with payment prevented an average of \$9.3 million in fraudulent claims per year. With continued resources and the ability to maintain system enhancements, the UPD will be able to prevent more fraud from being paid and possibly impede future fraudulent attempts. The SCO indicates that UPD will continue to track results and work toward identifying more system enhancements and other methods to improve the program. A review, audit, and analysis of prior year paid claims was conducted by the UPD in the most recent fiscal year in order to enhance processes and procedures and provide updated training to claims evaluators on ways to mitigate future fraud. This process also has allowed the UPD to add identifying criteria from fraudulently paid claims.

Staff Comment. The proposal would allow the SCO to continue the current level of fraud detection and prevention activity and result in estimated General Fund avoided costs of almost \$8.0 million annually. While there is a significant drop in fraud detection and prevention activity after the temporary funding expires in 2019-20, the program resources can be reviewed for sufficiency prior to that time to determine whether additional resources would be warranted.

Staff Recommendation: Approve as budgeted.

Vote.

Issue 6: Unclaimed Property Holder Compliance Initiative (BCP 003)

Governor's Proposal. The State Controller's Office (SCO) requests \$1.2 million from 2016-17 through 2018-19 for 11.0 positions, and \$1.5 million permanent funding for 12.1 positions from 2016-17, and ongoing, from the Unclaimed Property Fund. The resources will be employed for the purposes of reuniting owners with their lost and abandoned property by continuing the holder outreach and compliance program. The program identifies and contacts non-reporters or inconsistent reporters of unclaimed property, and attempts to bring them into compliance with the Unclaimed Property Law (UPL). This proposal is estimated to return to California residents an estimated \$80.4 million in property. For 2016-17 through 2018-19, 16 positions will be assigned to audit activity, six positions to unclaimed property and one to administration. The current proposal will allow for the program to continue its current level of activity through 2018-

19, after which the cessation of the limited-term funding will reduce the number of audit staff to 6.1 positions and eliminate the administrative position.

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

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

The 2011-12 budget included funding of 23.6 three-year limited-term positions and \$2.4 million to develop and implement the program. Of the 23.6 positions, the SCO's Division of Audits received 16.5 positions to perform audits of unclaimed property holders, 6.0 positions were allocated to the UPD for the outreach and compliance unit, and the remaining 1.1 positions were for administration support. Through a 2014-15 budget proposal, these resources were basically continued, as the SCO received 23.0 two-year limited-term positions and \$2.5 million to continue the program. The SCO audits received 16.0 positions to continue audits of unclaimed property holders, 6.0 positions were allocated to the UPD to continue outreach and compliance efforts, and the remaining 1.0 position was for administration support.

Staff Comments. The continued commitment of resources makes sense given the continued level of activity associated with unclaimed property. As with the accompanying budget request related to fraud detection and prevention of fraud related to unclaimed property, the years after 2018-19 are somewhat of an open question in terms of necessary resources to maintain the program; however, this issue can be revisited at a future time.

Staff Recommendation: Approve as budgeted.

Vote.

8860 DEPARTMENT OF FINANCE

Department Overview. The Director of Finance serves as the Governor's chief fiscal policy advisor and the primary functions of the Department of Finance (DOF) are to: prepare, explain, and administer the annual financial plan for the state; establish fiscal policies for all state departments; analyze proposed legislation for fiscal and policy impacts; monitor and audit expenditures by state departments to ensure compliance with the law, approved standards, and policies; and analyze the fiscal impact of information technology projects. The Office of State Audits and Evaluations (OSAE) supports DOF in supervising the state's financial and business policies through independent audits, evaluations, and related services.

Issue 1: Audit of Tax Compliance and Enforcement Programs

Budget Proposal. An audit evaluation of the Board of Equalization's (BOE's) audit and collections activities related to the sales and use tax would provide important information regarding the most effective deployment of budgeted resources and help ensure the efficient use of taxpayer dollars. The administration has indicated that an effective evaluation would require an augmentation to DOF of \$400,000 in one-time funding if conducted by OSAE. Proposed provisional language governing this report is as follows:

XXX. Of the amount appropriated in Schedule (3), \$400,000 shall be available for the Office of State Audits and Evaluations to perform an evaluation of the Board of Equalization's Sales and Use Tax Department's activities, including, but not limited to, audits, collections, compliance enforcement, and outreach. The scope and objectives of the evaluation shall be defined by the Department of Finance in consultation with the Legislature. A report shall be provided to the Chairs of the Fiscal Committees of each house of the Legislature and the Chair of the Joint Legislative Budget Committee by March 31, 2017.

Background. The Board of Equalization (BOE) is responsible for administering the sales and use tax for the state, local governments and various special funds. Sales and use tax revenues are expected to total about \$26 billion for the General Fund in 2016-17, representing about 21 percent of total revenues to the fund. While taxpayer compliance with the sales and use tax law is high, effective enforcement and compliance efforts are a necessary component of every modern tax system. The BOE has several programs that focus on compliance and enforcement, largely in the areas of education, audit and collections.

The 2002 Budget Act requires an annual supplemental report to be provided by the BOE to the Legislature regarding sales and use tax audits and collections. Subsequent refinements to this reporting include requirements to: analyze outcomes of audit system improvements; incorporate of average and marginal benefit to cost ratios; and assess the Statewide Compliance and Outreach Program. The supplemental report provides a useful tool for the Legislature to assess the effectiveness of the existing audit and compliance efforts, as well as means by which to measure whether the level and design of current efforts are appropriate.

Existing budget bill language set forth in Provision 1 of Item 0860 stipulates, in part, that “The State Board of Equalization shall not reduce expenditures or redirect funding or personnel resources away from direct auditing or collection activities without prior approval of the Director of Finance. The director shall not approve any such reduction or redirection sooner than 30 days after providing notification to the Joint Legislative Budget Committee.” The language further states that: “Furthermore, the board shall expeditiously fill budgeted positions consistent with the funding provided in this act.”

As part of the state’s efforts to work toward efficient and fair tax administration, similar reporting language and provisional budget language are in effect for the state’s other tax administration and collection agency, the Franchise Tax Board, which is responsible for personal income taxes and corporation taxes.

Staff Comment. Fair and consistent revenue collection is vital for providing funding for government programs and services, as well as to ensure compliance such that all taxpayers remit tax liabilities owed under the law. Existing reporting requirements and provisional language have helped provide for the effectiveness of the agency’s enforcement and compliance activities. In addition, given changes in technology, audit techniques and taxpayer behavior, an outside examination of how valuable state resources are being deployed in this area is warranted. Given DOF’s fiscal role and the charge given to OSAE, it is appropriate that these entities conduct this evaluation. Committee staff has coordinated with the Administration on this issue and the DOF is generally supportive of the proposal; however, it does not constitute an Administration proposal.

Staff Recommendation. Approve the proposed budget augmentation of \$400,000 one-time and BBL.

Vote.

8880 FINANCIAL INFORMATION SYSTEM FOR CALIFORNIA

Project Overview. Over the last several years, the Administration has been engaged in the process of putting in place a new information technology (IT) system for the state. This has involved the design, development and implementation of the Financial Information System for California (FI\$Cal), which will eventually replace the state's current decentralized system for budget, accounting, cash management and procurement. The project is being implemented to integrate and significantly re-engineer the statewide business processes related to budgeting, accounting, cash management, and procurement, and it will embed more standardization, transparency, discipline, effectiveness, and efficiency in these crucial business processes.

The state's legacy systems were built in the 1970s and 1980s and have exceeded their useful lives. The systems generally do not communicate with each other, and business operations often rely on separate downstream databases. These databases must also be maintained and often contain duplicative or inconsistent data. Because of the decentralized and antiquated nature of the state's business operating systems, the state's financial operations have become highly inefficient, costly to operate and maintain, and challenging to manage. When fully implemented, FI\$Cal is expected to eliminate hundreds of independent legacy systems and department-specific applications that now support internal business process operations of the state. Project costs are expected to total \$910 million, of which \$494 million is General Fund.

FI\$Cal is a complex undertaking, and the technical complexities are coupled with a somewhat complex and multi-tiered governance structure. The state's four fiscal control entities—Department of Finance (DOF), the State Controller's Office (SCO), State Treasurer's Office (STO), and Department of General Services (DGS)—all are represented on the governance entities. Representatives of these entities participate on the Project Steering Committee and the Project Directorate. This structure is necessitated by the balkanized statutory and constitutional assignment of the various fiscal responsibilities and duties that will be components of FI\$Cal. In addition, the Project Leadership Team is headed by an executive, who works with California Department of Technology (CalTech), and state and vendor staff on the operations of the FI\$Cal Service Center (FSC) which is the entity working directly on project implementation.

Issue 1: Funding for Special Project Report 6 - Project (BCP 001)

Governor's Proposal. The budget includes a request from FI\$Cal for \$45.1 million to support the changes identified in SPR 6. This brings the total 2016-17 budget to \$135 million (\$96.2 million General Fund, \$18.3 million Central Service Cost Recovery Fund (CSCRF) and \$20.5 million special funds). This request has been broken into two separate requests to identify the project costs and the establishment of the Department of FI\$Cal (discussed below). The 2016-17 project costs requested are \$92.4 million (\$71.9 million General Fund and \$20.5 million various special funds) and the departmental costs requested are \$42.6 million (\$24.3 million General Fund and \$18.3 million CSCRF).

During the development of Special Project Report (SPR) 6, FISCAL re-baselined its budget, evaluated and redirected existing resources to project or department activities, and identified additional costs. The change in project costs compared to SPR 5 are related to: system integrator costs (Accenture); project management and independent verification & validation (IV&V) contracts; additional project related contracts; and staff costs (FISCAL positions for technology staff, re-direction of existing resources; and, hardware/software related to SPR 6).

Background. FISCAL is an ambitious and complex project, and in reflection of this, the project has undergone numerous changes in scope, schedule and cost. These various changes have been incorporated and documented in SPRs with the project currently working under the rubric of SPR 5. The Governor's budget proposals are based on SPR 6, just released. SPR 6 incorporates intentional delays in the implementation of the project in order to increase the probability of success. The Legislative Analyst's Office (LAO) notes that project changes to date have led to schedule extensions and cost increases, but have also have led to modifications that have mitigated project risk and made project objectives more attainable.

Under SPR 5, a series of waves were to be set in motion, with each wave consisting of additional departments and system functionality. LAO notes that there were some 'early successes' in this process, but later some difficulties and delays occurred. Specifically, Wave 1 experienced technical difficulties which caused deferral of some functions to a series of deployments; departments required more technical support than anticipated; various unexpected challenges caused the deferral of some departments and functionalities to later waves. In Wave 2, concurrent and competing priorities created schedule delays; testing delays and requested enhancements required splitting up of waves. These delays and development resulted in delays in Wave 3 and Wave 4. This pushed additional functionality and departments back to the final Wave 4, increasing the risk to the project.

Under the changes proposed, the project would transition from implementing "waves" to "releases", allowing departments that are not ready to implement on the scheduled date to come on line at a later time. The amended approach establishes new programs to assist departments' transition to the project, and revises the implementation schedule for remaining releases. These changes result in increased costs for the project and an increase in the overall timeline for the project of two years. This extension includes one year of knowledge transfer that will facilitate state staff take-over of the project.

The State Auditor has expressed concerns about the project in its Letter Report, dated January 7, 2016. In this report, the high level concerns noted by the auditor include the following:

- The project has experienced significant deviations in its system implementation schedule and scope such that it is required to develop a new implementation plan through a sixth SPR.
- The project has not adequately responded to its oversight entities' concerns and recommendations, many of which have been outstanding for over a year.

- The project continues to report an overly optimistic percentage of completion in its monthly status reports, which are available on the California Department of Technology's website.
- The project experienced widespread turnover in its executive management team during 2015, and its staff vacancy rate remains stagnant.

LAO Comments. In its recent analysis of the FI\$Cal project, the LAO noted that the release approach is more realistic going forward and views the revision as improving the flexibility for the implementation. They view the addition of the knowledge transfer to the scope of the project favorably, but indicate that some additional time may be required for final project completion. Finally, the office notes the cost is still dependent on contract negotiations with the vendor.

Staff Comments. The FI\$Cal project is vital to the modernization of the state's fiscal management and control structure. While there have been delays and cost increases, as is typical for most IT projects with this degree of complexity, generally the project is on a positive course. It is essential that the project continue to be given adequate resources and support to ensure its success. Staff is supportive of the budget request, but continues to have some reservations regarding the timeline. It is likely that given the magnitude of the work that has been pushed to the back end of the project date, that an additional SPR will be required, even without additional unexpected complications or developments. Nevertheless, after discussions with the project and DOF staff, the current timeline currently seems to be a reasonable structure under which to conduct the next phases of the project. The department should address for the committee, the issues raised in the January Letter Report of the State Auditor, especially regarding any remedies of the concerns of the oversight entities. In addition, because of the crucial nature of next year's July release, with 50 departments and all functionality (save public transparency website) scheduled to be live, staff recommends that this committee or appropriate policy committee hold an oversight hearing on the project in mid-course of this year and require an report from the project at that time. Ordinarily staff would recommend committee approval of this issue at this time; however, the project proposal contours may be affected by the departmental proposal discussed in the following issue.

Staff Recommendation. Hold open.

Vote.

Issue 2: Funding for Special Project Report 6 - Department (BCP 002 and Trailer Bill Language)

Governor's Proposal. The budget includes a request from FI\$Cal for \$45.1 million to support the changes identified in SPR 6. This brings the total 2016-17 budget to \$135 million (\$96.2 million General Fund, \$18.3 million Central Service Cost Recovery Fund (CSCRF) and \$20.5 million special funds). This request has been broken into two separate requests to identify the project costs and the establishment of the Department of FI\$Cal. The FY 2016/17 departmental costs requested are \$42.6 million (\$24.3 million General Fund and \$18.3 million CSCRF). The

project costs requested of \$92.4 million (\$71.9 million GF and \$20.5 million various special funds) are being submitted in a companion BCP.

The cost of operating the Department of FISCAL would be funded 57 percent from the General Fund and 43 percent from the CSCRF. The CSCRF portion would be paid for by allocating the operational cost to departments based on their share of use. The annual cost of operating the department will increase in future years as new functions and departments come onto the FISCAL system. The cost of operating the department is expected to level off in 2019–20, at which point the annual ongoing cost is expected to be \$70.4 million (\$40 million General Fund).

The proposed department would include 122 positions (99 of which would be shifted from the project to the department) to support the FISCAL maintenance and operations. This position total will grow over time as the FISCAL system becomes more mature and as other staff working on design, development and implementation activities and finishing up the implementation work for the project, shift to ongoing activities. By 2019–20, it is estimated that the department will be comprised of 274 ongoing positions, primarily dedicated to maintenance and operations of the FISCAL System.

The accompanying trailer bill language establishes the Department of Fiscal effective July 1, 2016; establishes the director of the Department of FISCAL, to be appointed by the Governor, who will oversee the day-to-day functions of the Department of FISCAL and the implementation of the FISCAL project documents; change the interim cost allocation plan to fund the FISCAL project and Department of FISCAL; make all automated accounting systems referred to in Government Code Section 13000 inoperative after required data and departments using the system have transitioned to the FISCAL System

Background. To date, FISCAL has been a statewide Information Technology (IT) project, approved through a Department of Finance (DOF) Feasibility Study Report in 2005. Since then, it has gradually transitioned away from the DOF, becoming its own entity, with increasingly more authority, effectively transitioning to a fully functioning state department. Total project costs included departmental functions such as human resources, accounting, budgeting, contracts and procurement, business services. During the development of SPR 6, existing positions and costs were re-evaluated and redirected to align with project or departmental functions. Additional resources are needed to fully staff the units where existing staff could not be redirected.

LAO Comments. The LAO noted in its report that there may be alternative options to creating a new department at this time, including maintaining the current FISCAL Service Center (FSC) or delegating responsibility for the project to one of the four participating state offices. The analysis indicates issues and potential difficulties with each of the three options. The analysis notes that accountability may continue to be a problem under the Governor’s proposal and recommends additional steps to improve this regardless of the particular organizational structure chosen. In addition, LAO points out two potential solutions for accountability: (1) shift the role of the control agencies to one of advisory rather than formal decision-making and (2) elevate the project leader to the steering committee.

Staff Comments. Given the number of state entities responsible for fiscal and other control functions in the state, the design of the administrative structure with responsibility for FISCAL is not likely to resemble that of a typical state department. The trick here is to design an organizational structure that maximizes the positives associated with the different control agencies and attempts to minimize the potential drawbacks associated with multiple lines of authority and responsibilities. It is not apparent that establishing a stand-alone department at this time is warranted, or if so, it should be based on the particular design proposed. The committee may wish to ask the LAO to describe its concerns with the proposal and suggestions for alternative structures that may be suitable. The design of the particular organization best suited for the FISCAL project may well benefit from further discussions and analysis.

Staff Recommendation. Hold open.

Vote.