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MAJOR ISSUES

%***Performance Budgeting Pilot Program.*** The departments that are participating in the pilot program are at various stages of implementation, and each has incurred substantial costs thus far. Although the program continues to present an opportunity to “reinvent” state government, few of its objectives have been realized so far. We make a number of recommendations related to the program, including requiring pilot departments to commit to specific outcomes. (See pages H-13 to H-24.)

%***Plans for Restructuring Information Technology Still Pending.*** It is not clear whether the administration's plan to restructure state information technology will address the recommendations of three independent studies for changes in the state's information technology programs. Major problems identified in all three reports remain unresolved, and some new technology initiatives have been placed on hold pending the restructuring plan. (See pages H-25 to H-28.)

%***Legislative Oversight of Collective Bargaining Agreements.*** Existing collective bargaining agreements expire June 30, 1995. We recommend that the Legislature adopt policies, and enact legislation, to assure that the Legislature has the opportunity to appropriately review the proposed new agreements as well as future agreements. We also recommend that the Department of Personnel Administration report to the fiscal committees on the status of the current negotiations and on information to be sent to the Legislature with the completed agreements. (See page H-30.)

%***Disappointing Results from Manager/Supervisor Reductions.*** In the 1994 Budget Act, the Legislature adopted the Governor's proposal to reduce the numbers of managers and supervisors by a statewide average of 10 percent and reflected the administration's estimated savings of $150 million ($75 million General Fund) in the current year. The administration's implementation of this proposal, however, has resulted in only a $4 million savings from all funds ($1 million General Fund). (See page H-34.)

%***State Telecommunications System Losing Money.*** Despite an investment of $20 million, and plans for additional expenditures of $50 million by 2001-02, the California Network System (CALNET) continues to lose money while some state agencies buy telecommunications services from the private sector. The Department of General Services' (DGS') plan to hire a consultant to study the state's telecommunications needs and make strategic recommendations is a step in the right direction. However, the consultant's efforts will be dependent on the DGS' ability to develop a contract that allows for an unbiased assessment of solutions. (See pages H-70 to H-71.)

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OVERVIEW

Funding for state administration is proposed to increase substantially in the budget year primarily because of increased General Fund transfers to the Public Employees' Retirement System.

The budget proposes total expenditures for state administration of $6.1 billion in 1995-96, an increase of 20 percent above estimated current-year expenditures. When adjusted for inflation, total expenditures for state administration have increased 20 percent since 1988-89. Proposed General Fund spending for state administration is $4.5 billion, or 11 percent of all General Fund expenditures proposed in the Governor's Budget for 1995-96.

SPENDING BY MAJOR PROGRAMS

Figure 1 (see next page) shows state expenditures for nine major administration programs in 1993-94 and 1994-95, and as proposed for 1995-96. The Department of General Services, while not included in this figure, is projected to spend $265 million on statewide support services, a decrease of $28 million, or 9.5 percent, less than current-year expenditures. The decrease is the result of the budget's proposal to transfer the functions and staff of the California State Police to the California Highway Patrol.

Local Government Aid

The largest program in state administration is the shared revenues program, which distributes state-collected revenue to local government

Figure 1

State Administration Budget Summary[a,b] 1993-94 Through 1995-96

(Dollars in Millions)

	Actual 1993-94	Estimated 1994-95	Proposed 1995-96	Change From 1994-95 Amount	Change From 1994-95 Percent
Shared Revenues					
General Fund	$0.3	$0.3	$0.3	—	—
Special Funds	2,910.8	2,129.5	2,170.7	$41.2	1.9%
Totals	**$2.911.1**	**$2,129.8**	**$2,171.0**	**$41.2**	**1.9%**
Tax Relief					
General Fund	**$471.4**	**$476.8**	**$458.1**	**-$18.7**	**-3.9%**
Contributions to Teachers' Retirement Fund[c]					
General Fund	**$757.7**	**$824.2**	**$845.0**	**$20.8**	**2.5%**
Health Benefits for Annuitants					
General Fund	**$296.9**	**$300.5**	**$295.7**	**-$4.8**	**-1.6%**
Augmentation for Employee Compensation					
General Fund	$112.2	$43.5	—	-$43.5	-100%
Special funds	52.0	30.4	—	-30.4	-100
Totals	**$164.2**	**$73.9**	**—**	**$73.9**	**-100%**
Transfers to Public Employees' Retirement Fund					
General Fund	—	$91.0	$443.7	$352.7	387.5%
Special funds	$197.3	241.5	254.7	13.2	5.5
Totals	**$197.3**	**$332.5**	**$698.4**	**$365.9**	**110.0%**
Payment of Interest on General Fund Loans					
General Fund	**$105.5**	**$258.0**	**$675.0**	**$417.0**	**161.6%**
Board of Equalization					
General Fund	$154.1	$163.4	$169.5	$6.1	3.7%
Special funds	15.3	18.3	21.6	3.3	18.0
Totals	**$169.4**	**$181.7**	**$191.1**	**$9.4**	**5.2%**
Franchise Tax Board					
General Fund	$248.6	$283.5	$309.9	$26.4	9.3%
Special funds	5.6	7.9	8.3	0.4	5.1
Totals	**$254.2**	**$291.4**	**$318.2**	**$26.7**	**9.2%**

[a] Excludes reimbursements, revolving funds, and other nongovernmental cost funds.

[b] Detail may not add to totals due to rounding.

[c] Excluding state mandate costs.

agencies. The $41 million increase in spending reflects an increase in the Motor Vehicle License Fund (VLF) apportionments to local governments as a result of growth in the fee revenues collected.

The state provides property tax relief, both as subventions to local governments and as direct payments to eligible taxpayers, through seven tax relief programs. Historically, the two largest are the Homeowners' Property Tax Relief (Homeowners' Exemptions) and Renters' Tax Relief (Renters' Credit) programs. As part of the budget solutions over the last several years, however, the Renters' Credit program has been suspended from 1993 through 1995. The budget proposes a decrease of nearly $19 million for tax relief programs from $477 million in 1994-95 to $458 million in the budget year. This change primarily is due to the elimination of $25 million in one-time aid for property tax administration provided to counties in the current year, offset by mild growth in the number of taxpayers qualifying for the Homeowners' Exemption.

The Governor's Budget also proposes a state/county restructuring which would (1) shift approximately $1.9 billion in program costs from the state to the counties and (2) provide counties with $1.6 billion in state sales tax revenue and other resources. We discuss this proposal in detail in *The 1995-96 Budget: Perspectives and Issues* (see Part V).

Retirement

PERS. The budget projects a $443.7 million General Fund transfer to the Public Employees' Retirement System (PERS) in 1995-96. The General Fund transfer in 1994-95 was only $91 million due to the one-time availability of offsetting credits. The 1995-96 General Fund contribution is based on the 1993-94 state employee payroll, pursuant to Ch 71/93 (SB 240, Committee on Budget and Fiscal Review). Under the provisions of that legislation, General Fund contributions to the PERS are made two fiscal years in arrears. As a result of a lawsuit filed by the PERS, the Superior Court in Sacramento County has ordered the state to immediately pay *all* deferred payments and to resume sending state funds to the PERS on a current, rather than deferred, basis. The state has appealed this decision and the budget assumes that the state will prevail on appeal. If the state loses the appeal, the General Fund impact could would be about *$1 billion.*

STRS. The State Teachers' Retirement System (STRS) receives contributions from teachers and their employers. These contributions, however, are insufficient to provide for the cost of teachers' basic retirement benefits and the protection of retirees' purchasing power. The shortfalls are covered by annual transfers from the General Fund. These transfers are expected to increase by $21 million, from $824 million in the current year to $845 million in the budget year. The increase is due to an expected increase in teacher payrolls, which is the key factor in the statutory funding formulas.

Health and Dental Premiums. The budget also includes $296 million from the General Fund to pay the state share of health and dental insurance premiums for retired state employees and their qualifying beneficiaries. This is $4.8 million less than estimated current-year expenditures. The reduction is the net result of significant decreases in the state contributions for health plan premiums (as calculated under the statutory formula), and an increase in the number of retirees.

Employee Compensation

Most state employees received a 3 percent pay increase on January 1, 1995. The budget does not compensate departments for the full-year (annualized) effect of that increase that will occur in 1995-96, with the exception of health, safety, and revenue-generating departments and those funded by special funds. The budget also does not propose funds for any new pay or benefit increases.

The collective bargaining memoranda-of-understanding (MOUs) that govern pay, benefits, and other working conditions for rank-and-file employees expire June 30, 1995. In his budget summary, the Governor expresses his expectation that management and labor can provide " . . . a compensation program that is driven by performance and not by across-the-board compensation adjustments . . . ," through new MOUs to be negotiated with labor's 21 bargaining units.

We discuss employee compensation issues in further detail in the Crosscutting Issues section of this chapter.

Tax Agencies

The Board of Equalization collects state and local sales and use taxes and various excise taxes and fees; oversees the administration of the property tax; assesses public utility property; and hears appeals of decisions by the Franchise Tax Board. The budget proposes expenditures of $191.1 million for the board in 1994-95 (exclusive of $91 million in reimbursements from local governments). This is an increase of $9.4 million (5.2 percent) over estimated current-year expenditures. About 25 percent of the proposed increase is attributable to the development and acquisition costs of an automated system to accelerate the collection of delinquent taxes.

The Franchise Tax Board is responsible for administering California's Personal Income Tax, Bank and Corporation Tax, Homeowners' and Renters' Assistance programs, and the Political Reform Act audit program. Funding for the board is proposed to increase by $26.7 million, (9.2 percent) most of which is attributable to Bank and Corporation Tax computing system redesign expenditures.

MAJOR BUDGET CHANGES

Figure 2 (see page 10) portrays the changes in three major categories of expenditure (retirement benefits, local government aid, and employee compensation) which reflect some of the increase in state administration spending in 1995-96. Also shown are selected changes in each of the categories.

The State's Retirement Programs

Retirement-related expenditures account for a significant part of state spending for the budget year. In 1995-96, state expenditures for various costs associated with public employee retirement (excluding University of California costs and nongovernmental cost funds) will total approximately $2.4 billion, including nearly $1.9 billion from the General Fund. As summarized in Figure 3 (see page 11), the General Fund provides for employer contributions and/or various other payments to four public employee retirement systems: the Public Employees' Retirement System (PERS), the State Teachers' Retirement System (STRS), the Judges' Retirement System, and the Legislators' Retirement System. In addition, the state (1) makes social security and Medicare contributions for most state employees and (2) contributes to the payment of premiums for health and dental benefit plans for retired state employees.

Figure 2

State Administration
Proposed Major Changes for 1995-96
All State Funds

Retirement Benefits	**Requested:**	**$2.4 billion**	
	Increase:	**$413.5 million**	**(+17.2%)**

+

- $365.9 million for transfers to the Public Employees' Retirement Fund (excludes transfers from nongovernmental cost funds)
- $20.8 million for transfers to the State Teachers' Retirement Fund (excludes related state mandate costs)
- $20 million for Social Security/Medicare taxes
- $11.6 million for contributions to Judges' Retirement Fund

−

- $4.8 million for health and dental premiums for retirees

Local Government Aid	**Requested:**	**$3.6 billion**	
	Increase:	**$28.8 million**	**(+0.8%)**

+

- $41.0 million in Motor Vehicle License Fund apportionments to local governments

−

- $25 million elimination of one-time aid for property tax administration

Employee Compensation Increases	**Requested:**	**$0**	
	Decrease:	**$73.9 million**	**(-100%)**

−

- $73.9 million due to absence of pay increase for state employees in 1995-96.

Figure 3

General Fund Costs for Retirement Programs[a] 1995-96

(In Millions)

Program	1995-96
Public Employees' Retirement	$444
State Teachers' Retirement	899
Judges' Retirement	57
Legislators' Retirement	1
Social Security and Medicare	242
Health and Dental Benefits for Annuitants	296
Total	**$1,939**

[a] Includes transfers to retirement trust funds for employer contributions, state mandates, retired judges' benefit payments, and other purposes. Does not include PERS and STRS administrative expenditures from trust funds. Excludes costs for University of California employees.

STATE ADMINISTRATION

CROSSCUTTING ISSUES

PERFORMANCE BUDGETING: COSTS ARE CERTAIN, RESULTS ARE PENDING

The Governor's Performance Budgeting Pilot Program continues to present an opportunity to "reinvent" state government to make it more effective, but the cost of reinvention is significant, and whether state departments can provide better service at the same or less cost has yet to be determined.

In this section we summarize the performance budgeting program, including its current status, and identify common themes and issues which have emerged as the administration implements this new program. We conclude with recommendations we believe can help to make performance budgeting more effective. For a more specific description of individual departments' performance budgeting efforts, please refer to those departments in other sections of this *Analysis*.

Background

What Is Performance Budgeting? Performance budgeting differs from the traditional approach to budgeting in that it focuses on outcomes, rather than processes or inputs. It allocates resources based on expectations of performance. And it measures performance in order to assess (1) how well a department is achieving its desired outcomes and (2) whether its performance is improving over time. Consequently, to implement performance budgeting, departments must identify performance *goals*, or outcomes, and the performance *measures* that will be tracked and analyzed to determine progress toward meeting the desired outcomes.

Governor Initiates Pilot Project. In January 1993, the Governor proposed to change the state's budgeting process by pilot testing performance budgeting in four state departments. According to the Governor's Budget, the pilot program was being proposed because the state's traditional budget process was "seriously dysfunctional." The administration indicated that performance budgeting, along with quality improvement, offered the potential for substantial savings, improved performance, enhanced citizen satisfaction, and greater accountability in the delivery of state services.

The Legislature responded to the Governor's initiative by enacting Ch 641/93—the Performance and Results Act of 1993 (SB 500, Hill)—which essentially codified the administration's proposal, but also required budget "contracts" with the Legislature in 1994-95, and completion of the pilot project by January 1, 1996. Budget contracts require departments to deliver specified outcomes for a specified level of resources. They also identify criteria for evaluating outcomes and specify provisions for reinvesting savings resulting from performance budgeting. Chapter 641 also authorized expansion of the pilot project to include other departments, or to substitute departments.

Chapter 672, Statutes of 1994 (SB 1609, Hill) requires that a draft budget contract be submitted to the fiscal subcommittees of the Legislature by January 31 if the contract is proposed to be effective in the pending fiscal year.

Finally, the Legislature enacted Ch 779/94 (AB 2711, Valerie Brown)—the State Government Strategic Planning and Performance Review Act—which (1) requires the Department of Finance (DOF) to identify state agencies which should either develop a strategic plan or update an existing one, and (2) requires those agencies to report annually to the Legislature on steps being taken to develop performance measures that could be used for performance budgeting or performance review.

LAO's Initial Assessment of Performance Budget and Pilot Project. In October 1993 we released a policy brief on performance budgeting, including an assessment of the Governor's pilot program to that date. Figure 4 summarizes the key findings contained in the policy brief, which apply broadly to performance budgeting as it had been tried in several states and localities.

Figure 4

Performance Budgeting
Key Findings
LAO 1993 Policy Brief

- ✔ The manner in which performance budgeting is applied and the results it produces vary widely among the states
- ✔ In most instances, performance budgeting has *not* fundamentally changed the budget process
- ✔ Implementation costs are significant
- ✔ Performance measures need to focus on *outcomes*, not process
- ✔ Performance needs to be verified independently
- ✔ Performance budgeting requires a change in the Legislature's perspective towards the budget process
- ✔ The Legislature must be willing to accept a longer-term view of implementation and results
- ✔ California's pilot project lacked sufficient definition

We noted in our report that the foundation of the Governor's pilot program—reshaping the state's budget process—would not be easy to accomplish because performance budgeting is complex. Also, we concluded that the pilot project in California lacked sufficient details. Recognizing the important role the Legislature would have to play to ensure success of the project, we recommended the establishment of a joint legislative committee to oversee the pilot project and review the budgets of the pilot departments.

Current Project Status

The DOF is responsible for administering the performance budgeting pilot program which currently includes five departments:

- California Conservation Corps
- Department of Consumer Affairs
- Department of General Services
- Department of Parks and Recreation
- Department of Toxic Substances Control

The Departments of General Services, Consumer Affairs, and Parks and Recreation were among the original four departments selected to participate in the pilot. The fourth department—the Stephen P. Teale Data Center—is no longer a participant, according to the DOF. The California Conservation Corps and the Department of Toxic Substances Control were added in 1994. No additional departments are proposed for 1995-96, and the DOF advises that no additions are contemplated.

Some Departments Are Ahead of Others. Not surprisingly, the rate of progress in implementing performance budgeting has varied among the participating departments. As noted above, establishing a performance budgeting system is complex, and some of the pilot departments are larger and more complex than others. Other factors contributing to a variation in progress include:

- Whether a department already had a strategic plan in place.
- The difficulty in determining appropriate performance measures.
- Negotiations with the control agencies (DOF, State Personnel Board, Departments of Personnel Administration and General Services) to increase administrative flexibility.
- The learning curve each department has had to undergo because when the performance budgeting pilot project was initiated, no one really had a good idea of the magnitude of the effort or what a budget contract would actually look like.

Despite these factors, and although much remains to be accomplished, some departments have made considerable progress toward implementing performance budgeting. Figure 5 depicts the current status of the pilot departments.

Figure 5

Pilot Department Accomplishments to Date

	Department				
	California Conservation Corps	Consumer Affairs	General Services	Parks and Recreation	Toxic Substances Control
Strategic Plan in Place	U	U	U	U	U[a]
Quality Assurance Program in Place	U	—	U	U	b
Performance Goals Established	U	—	—	U	—
Performance Baseline Established	U	U	U	U	—
Performance Measures Completed	U	U	c	U[d]	—
Performance Report Format Defined	U	U	U	U	—
Budget Contract in Place (1994-95 FY)	—	U	—	U	—
Information System(s) in Place	U	—	b	b	b

[a] Draft plan has been completed and is being refined.
[b] Partial completion.
[c] Final revision pending.
[d] Measures relate more to output—not outcomes or goals.

Common Themes

Several common themes have emerged during the implementation of the pilot project as displayed in Figure 6 (see next page).

Cost to Implement Performance Budgeting. In our October 1993 policy brief we noted that the cost to implement the pilot project would be significant; and, in the *Analysis of the 1994-95 Budget Bill* we recommended that the DOF advise the Legislature as to its estimate of costs and benefits associated with the administration's performance budgeting plans. To date, no such estimate has been provided. Because

Figure 6

Characteristics of the Performance Budgeting Pilot Program

- ✔ A significant investment of resources has been made (see Figure 7 for details)
- ✔ There is no common approach to developing a budget contract
- ✔ Administrative flexibility provided by current budget contracts appears to be relatively minor
- ✔ Too early to determine whether performance budgeting will meet the primary goals established by the Governor
- ✔ Other than the use of budget contracts, there has been no significant change in the budget process

departments are absorbing the costs to implement performance budgeting, the costs are not apparent. However, several pilot departments have acknowledged that there has been a substantial investment in staff time alone, and some departments have contracted for consultants to help in the development of strategic plans. We asked the pilot departments to provide us their best estimates of their costs of the performance budgeting pilot. These estimates, which should be viewed as rough, are reflected in Figure 7.

These costs do not include the cost of quality improvement programs, which many of the performance budgeting pilot departments have in place, nor do they include the cost of information systems which we believe will have to be developed. Experience in the private sector has shown the cost of an effective quality improvement program to be quite substantial, primarily because such a program typically entails initial and ongoing training of every employee, as well as periodic work group meetings. Although the Governor has identified a commitment to quality improvement as an essential element of performance budgeting, departments participating in the pilot program have not accounted for the cost of these programs, nor do they seem to consider them to be a part of the cost of the performance budgeting pilot program. Regarding information systems, departments are currently working with a combination of existing computer programs and manual methods. We believe that ultimately, new systems will be required.

Figure 7

Costs of the Pilot Project Through 1995-96

(In Thousands)

	Department				
	California Conservation Corps	Consumer Affairs	General Services	Parks and Recreation	Toxic Substances Control
Consulting Contracts	$42	$305[a,b]	$110	$8	$0
Staff Time	498	2,274[a]	1,070	256	512
Training	0	[c]	55	0	0
Totals	**$540**	**$2,579**[a]	**$1,235**	**$264**	**$512**

[a] Estimated through December 31, 1994.

[b] Includes training.

[c] Included in "Consulting Contracts."

Increased Administrative Flexibility. A long-standing and frequent complaint of state managers at all levels has been the inability to get the job done effectively because of a myriad of controls on their ability to administer programs. One of the more attractive features of the performance budgeting pilot project to departments is the prospect of being provided additional administrative flexibility. (Another attractive aspect is the potential of being allowed to retain 50 percent of the savings resulting from the pilot.) Although the 1994-95 budget for three of the original four pilot departments reflects a relaxation of certain administrative controls, the flexibility which has been provided appears relatively minor. Moreover, it can be argued that much of this flexibility should have been provided regardless of the pilot program; for example, the Director of General Services was authorized to augment the budget up to 10 percent, without DOF approval, in order to cover unanticipated service requests from customer departments. No significant changes in pilot department operations have been observed to date.

Outcomes Have to Be Measurable. The primary purpose of performance budgeting is to produce results, or outcomes, which will demonstrate clearly and without question that governmental performance has been improved. Consequently, it is essential that the right activities be measured, because outcome reports will be based on those measurements. In Figure 8 we have listed those criteria which we believe should be applied to any proposed performance measure. To date, the effort in pilot departments has been primarily on establishing strategic plans and performance measures, and the adequacy of the measures which have been developed varies among the pilot departments.

Figure 8

Performance Measure Criteria

- ✔ Does the measure focus on *outcomes*, not process or procedures?
- ✔ Is the measure *relevant* to the activity being measured?
- ✔ Does the measure need to be *customized* to fit the specific program?
- ✔ Is the measure *reliable*—that is, will it produce accurate and verifiable information?
- ✔ Are *multiple* measures required in order to capture the complexity of the program?

No Significant Change in Budget Process. As noted above, the underlying premise of the Governor's pilot project is that the traditional budgeting process is dysfunctional, and performance budgeting is viewed as a better means of allocating resources. Also, it is believed that performance budgeting, along with quality improvement projects, could result in substantial cost savings, improved program performance, enhanced citizen satisfaction, and greater accountability. To date, other than budget contracts, there has not been a fundamental change in either the Governor's proposed annual budget or the process whereby the Legislature considers the budget; nor, as best as we can determine, have any of the other objectives described above been attained.

Changes Should Be Made to Pilot Project

We recommend that the Legislature adopt supplemental report language (1) limiting the number of departments participating in the performance budgeting pilot project to the five currently designated, (2) directing the DOF to study the Oregon Benchmarks program as a possible means to improve the California program, and (3) requiring that the DOF provide guidelines to pilot departments which will ensure a standard format for reporting performance, and avoid the independent and redundant development of information systems to support performance budgeting.

Limit the Pilot Program to the Current Participants. Chapter 641, Statutes of 1993, requires the DOF to provide the Legislature, on or before January 1, 1996, an evaluation of the pilot project. This evaluation must determine the extent to which performance budgeting results in a more cost-effective and innovative provision of government services and the amount of savings attained by participating departments. Given the uncertain results of the project to date, we recommend that project participation be limited to the current departments, pending receipt of DOF's evaluation. The DOF has indicated that it has no plans at this time to add more departments to the pilot.

State Can Learn From Oregon's Experience. Oregon Benchmarks is a nationally recognized program established by the State of Oregon to provide measurable indicators to assess progress toward broad strategic goals. The benchmarks are essentially performance goals which are tied to specific elements of the state's strategic vision, and are also used to establish budget priorities. Examples of benchmarks include reducing the rate of teen pregnancy, reducing the backlog of roads and bridges in need of repair and preservation, and increasing the payroll of designated industries. Each outcome is reported in a consistent format which displays an annual historical baseline along with three target years (1995, 2000, and 2010 in the most recent report). We believe that California could benefit from studying the Oregon program and incorporating those aspects of the program which would enhance performance budgeting in our state.

Redundant System Development Should Be Avoided. One component of performance budgeting which is potentially costly is the development of an information system to collect, store, process, and report performance and related data. Each pilot department has the same need for such an information system, yet currently each department is developing its own approach to fulfilling that need. Clearly, it would be to the state's advantage to develop a uniform system which could be used by all participants. This would not only save money and time for the current five departments, but would provide additional savings if and when additional departments adopt performance budgeting. Moreover, using a standard system would facilitate reporting results in a consistent manner and format (for example, as is the case with Oregon Benchmarks).

For these reasons, we recommend adoption of the following supplemental report language:

> With respect to the performance budgeting pilot project administered by the Department of Finance, the department shall (1) limit the pilot project to the five departments in the program as of January 10, 1995, (2) study the Oregon Benchmarks program and recommend that the Legislature adopt those aspects of the Oregon program which will enhance California's efforts, and (3) provide guidelines to pilot project departments which will (a) avoid the development of duplicative information systems to collect, store, process and report performance data, and (b) ensure that results are reported in a consistent manner and in a standard format.

Will Substantial Flexibility Yield Substantial Results?

We recommend that the Legislature consider negotiating a performance budget contract with the California Conservation Corps (CCC) which provides substantially more administrative flexibility than that which has so far been provided pilot departments, in order to provide a fuller test of the potential benefits of performance budgeting.

As noted above, the administrative flexibility provided performance budgeting pilot departments has been relatively minor. At the time this analysis was prepared, the proposed budget contracts for 1995-96 had not been provided to the Legislature by four of the five pilot departments, and the draft contract submitted by the Department of Parks and Recreation is the same as the 1994-95 contract. Thus, we do not know whether any of the four remaining contracts will propose substantially more administrative flexibility than was approved for 1994-95. Clearly, significant results cannot be expected from relatively minor changes in administrative flexibility. For that reason, we believe that it would be worthwhile to consider providing a substantial increase in administrative flexibility to an appropriate department in order to see what performance budgeting can deliver when a department is relatively unfettered.

In our view, an appropriate department would be one which is not only well-managed, but one which is also relatively small and fairly focused in its mission. On that basis, the CCC would be a likely candidate, and we recommend that the Legislature consider negotiating a budget contract with the CCC which provides substantially more administrative flexibility than it might be willing to approve for other performance budgeting pilot departments. An example of such flexibility would be to authorize the Director of the CCC to increase without DOF approval reimbursements to, and expenditures from, the Collins-Dugan CCC Fund. (For a more detailed discussion of the CCC's performance budgeting effort, please see the Resources Chapter of this *Analysis.*)

Budget Contracts Should Include Performance Commitments

We recommend that the Legislature not approve any budget contract for 1995-96 which does not include (1) the department's commitment to achieve specified outcomes in 1995-96 and (2) the criteria for evaluating outcomes.

As noted earlier, Ch 672/94 requires that pilot departments provide the Legislature a draft budget contract by January 31, 1995, in order to have the contract effective in 1995-96. Also, Ch 964/93 requires that departmental budget contracts (1) deliver specified outcomes for a specified level of funding, (2) identify evaluation criteria for determining outcomes, and (3) specify any provisions for reinvesting savings resulting from performance budgeting. At the time this analysis was prepared, only the Department of Parks and Recreation had submitted a draft budget contract by the January 31 deadline, and that draft is essentially the same as the 1994-95 contract. Neither it nor the Department of Consumer Affairs' 1994-95 budget contract include program outcomes, evaluation criteria, or proposals to reinvest savings.

We believe that contracts which do not include a commitment to achieve specified outcomes, or fail to identify the criteria for evaluating outcomes should *not* be approved by the Legislature. This is because, in the absence of information about performance outcomes and performance measures, the Legislature has no way to hold the departments accountable. Consequently, we recommend that the Legislature not approve any budget contract which does not contain specific commitments to achieve specific outcomes, or which does not contain the criteria necessary to evaluate the outcomes.

Performance Budgeting Only Part of the Solution

While the Governor's performance budgeting pilot project has been useful in terms of getting state organizations to focus on outcomes, it is important to realize that performance budgeting by itself will not cause the fundamental change in state government that is sought. Identifying strategic goals, developing priorities, measuring outcomes and allocating budget dollars accordingly may appear to represent fundamental change, but in the end it will be the state government's employees who will be responsible for whether services are delivered in a more responsive and effective manner. In that regard, continuous *quality improvement* programs will play a key role to ensure that the tools are available to get the job done, and those departments which have effective quality programs in place will most likely be the most successful with performance budgeting.

ADMINISTRATION'S PLAN TO RESTRUCTURE STATE INFORMATION TECHNOLOGY PENDING

The administration's plan to restructure state information technology has not been released. It is not clear whether the plan will adopt the recommendations of three independent studies, which proposed major restructuring of the state's information technology program. Major problems identified in all three reports remain unresolved, and some new technology initiatives have been placed on hold.

Three Independent Studies Concur on Information Technology Problems and Solutions

In 1994, three separate studies reviewed and identified fundamental problems with the state's planning, implementing, and managing of information technology (IT). Additionally, these problems received considerable discussion before various legislative committees. Although many of the problems were not new, they were highlighted by the failure of the Department of Motor Vehicles' (DMV) $49 million effort to replace its aging driver license and registration databases, as well as the disclosure of serious problems in a number of other major state IT programs.

The studies were conducted by our office (*Information Technology: An Important Tool For a More Effective Government*, June 16, 1994), a task force appointed by the Governor (*Report of the Task Force on Government Technology Policy and Procurement,* October 1994), and the Bureau of State Audits (*The State Needs to Reengineer Its Management of Information Technology,* December 1994).

Although each study contained unique findings and recommendations, there is a substantial amount of concurrence among all three studies, as reflected in Figure 9 (see next page).

All three studies concluded that the Office of Information Technology (OIT) should be eliminated, and a new organizational structure established which should report directly to the Governor.

Figure 9

**Improving the State's Use of Information Technology (IT)
Common Findings And Recommendations of Three Reports**

Topic	LAO (June 1994)	Governor's Task Force (October 1994)	Bureau of State Audits (December 1994)
Findings			
Insufficient statewide planning	U	U	U
Insufficient statewide coordination	U	U	U
Insufficient statewide leadership	U	U	U
Recommendations			
Reorganize state IT leadership	U	U	U
Establish IT advisory councils	U	U	U
Consolidate IT services	U	U	U
Improve project risk assessment and oversight	U	U	U
Train project managers	U	U	
Train contract managers	U		U
Break large projects into smaller components		U	
Increase the use of prototyping	U	U	
Reform the process for resolving protests of IT contract awards	U	U	U
Reform the process for acquiring consultants	U	U	

Legislature's Reaction

The Legislature took several actions in response to the identified problems. In several cases, the Legislature adopted Budget Bill language setting conditions on specific IT efforts which were determined to have serious problems. The conditions imposed by the Legislature ranged from advance reporting of planned IT activities (Stephen P. Teale Data Center), to the hiring of independent consultants by the Bureau of State Audits to review specific IT programs (DMV, Department of Social Services, and OIT). In addition, legislation was introduced to restructure IT oversight and operations. Finally, the Legislature passed SCR 53 (Alquist), which created the Joint Legislative Committee on State Information Technology, which has as its purpose:

- Monitoring and evaluating the state's IT infrastructure.
- Conducting oversight hearings and investigations as necessary to inform the Legislature about specific IT activities or needs.
- Recommending legislation to improve the effectiveness and coordination of IT projects being proposed, implemented, or operated by a state agency.

Implementation Plan Pending. On October 17, 1994, the Director of the Office of Planning and Research testified at the first hearing of the Legislature's Joint Legislative Committee on State Information Technology that his office was leading an effort to develop a plan for implementing the recommendations of the Governor's task force. The Director indicated that the plan was anticipated to be completed in December 1994. However, at the time this analysis was prepared, the plan had not been released.

1995-96 Governor's Budget

The *Governor's 1995-96 Budget Summary* indicates that the Governor has endorsed his task force's findings, including a proposal to eliminate the OIT in favor of establishing a State Chief Information Officer (CIO). The Governor indicated that he plans to hire a CIO early in 1995 as a senior member of his administration. Upon being hired, the CIO would be responsible for designing a new Office of the State Chief Information Officer and redesigning the state's IT practices. By July 1, 1995, the CIO would inherit the state IT responsibilities of the OIT. According to the budget, the CIO will present to the Legislature, prior to the May budget revision, a fiscal plan for the full implementation of the new office.

Budget Unclear as to Plans for the OIT. Although there appears to be a clear indication that the OIT will be replaced with a new office reporting more directly to the Governor, the proposed budget for the Department of Finance (DOF) includes $2 million for the full-year funding of the OIT in 1995-96. Consequently, in our analysis of the DOF in this chapter of the *Analysis*, we recommend that the department advise the Legislature as to its plans for the OIT.

***Serious IT Issues Noted in This* Analysis.** Until the administration acts, significant problems identified by the three independent studies will remain, for the most part, unaddressed. In addition, at least one project—the Electronic Commerce project in the Department of General Services—has effectively been put on hold until restructuring of OIT has occurred.

In this *Analysis* we discuss several specific departmental IT programs.

These issues highlight the continued difficulty the state is experiencing in its efforts to employ IT. Figure 10 lists those departments and projects discussed elsewhere in this *Analysis,* where we have identified IT issues.

Figure 10

Budgets with Information Technology Issues Identified in the 1995-96 *Analysis*

Department	Issue
Corrections	Correctional Management Information System
Office of Emergency Services	Planning for information technology
Board of Equalization	Contracting
Finance	Office of Information Technology
Franchise Tax Board	Contracting
General Services	CALNET
	Electronic Commerce
Health and Welfare Agency Data Center	Various
Health Services	Integrated Statewide Information System
Motor Vehicles	Database redevelopment project
Social Services	Statewide Automated Welfare System
	Statewide Automated Child Support System
	Child Welfare Services/Case Management System
Student Aid Commission	Financial Aid Planning System
Teale Data Center	Various

OVERVIEW OF EMPLOYEE COMPENSATION ISSUES

A major portion of state government expenditures is for compensation of state employees. The Governor's Budget projects $11.8 billion for salary and wage expenditures for 274,000 authorized personnel-years in 1995-96 (including $3.7 billion and 85,000 personnel-years in higher education). Including benefits, estimated compensation expenditures approach $15 billion for the budget year.

In this overview we discuss the following compensation issues:

- The administration's decision not to propose new pay or benefit increases in the budget.
- Collective bargaining negotiations currently underway.
- Legislative oversight of state employee collective bargaining agreements.
- The administration's policy change on compensating departments for the current-year cost of the January 1, 1995 pay increase.
- Changes in the administration's pay-for-performance policy.
- The results from the administration's current-year proposal to reduce the number of managers and supervisors.

Budget Does Not Propose Funds for New Pay or Benefit Increases

The budget does not propose funds for new pay or benefit increases for state employees, although it does augment higher education funding by $68 million for unspecified, general purposes.

State Operations. Most state employees received a 3 percent pay increase on January 1, 1995. We estimate that the annualization cost for this pay increase in 1995-96 will be about $137 million. The budget funds the 1994-95 and 1995-96 costs of all special fund agencies and 16 General Fund supported agencies having public safety, 24-hour care, or revenue-producing responsibilities. All other General Fund agencies had to absorb the cost of the 3 percent salary increase. The budget does not propose funds for new pay or benefit increases for state employees in 1995-96.

Higher Education. University of California (UC) employees received a 3 percent pay increase on October 1, 1994. California State University (CSU) employees received a 3 percent increase on April 1, 1994. In 1995-96, the budget provides $37 million to the UC and $31 million to the CSU for unspecified, general purposes. Under the Governor's proposal, each university system could choose to use all or part of these amounts to fund new pay and/or benefit increases. At the time this *Analysis* was prepared, however, neither system had finalized plans for new pay or benefit increases.

New Collective Bargaining Agreements Under Negotiation

The Department of Personnel Administration should report to the fiscal committees during budget hearings on the administration's collective bargaining proposals, the status of negotiations, and the format/nature of fiscal information to be provided to the Legislature with the completed bargaining agreements.

The Department of Personnel Administration (DPA) was scheduled to begin negotiations in January with the 21 bargaining units that represent rank-and-file state employees (other than higher education) for new memoranda-of-understanding (MOUs) governing compensation and other terms and conditions of employment. These MOUs will replace the existing MOUs that are to expire June 30, 1995.

In our analysis of the DPA's budget request, we recommend that the DPA report to the fiscal committees during budget hearings on the administration's collective bargaining proposals, the status of negotiations, and the format/nature of fiscal information to be provided to the Legislature with the completed bargaining agreements.

Legislation Needed to Strengthen Legislature's Collective Bargaining Oversight

We recommend that the Legislature adopt policies to assure that the Legislature will have the opportunity to fully review proposed collective bargaining agreements. For collective bargaining proposals in future years, we recommend that the Legislature enact legislation incorporating the policies into law, along with a requirement that the DPA report changes in the agreements to the Legislature.

The state's collective bargaining law reserves to the Legislature final review and approval of collective bargaining agreements for state employees. Moreover, the law appropriately calls for this process to occur as part of the Legislature's deliberations on the state budget. In practice, however, this framework seldom has been followed. In fact, the administration's practice in presenting the laws to the Legislature as “urgency” situations, has severely restricted review. The 21 current MOUs are a case in point. None of these three-year agreements, which began with the 1992-93 fiscal year, were presented to the Legislature either as part of the 1992-93 budget process or in a timely manner. Instead, the administration presented 20 of the 21 MOUs to the Legislature, as matters of urgency, at different times during 1992, as amendments to five bills. (The last MOU was presented in 1993.) In each case the bills were amended on the floor of the second house, bypassing not only the budget process but all policy and fiscal committee review as well. One bill was passed and sent to the Governor the same day the amendments were presented. The other bills were passed within four days of the amendments.

Historically, these MOUs contain many fiscal and policy issues that warrant close review by the Legislature. These issues are too important for the Legislature to approve without having full information on their fiscal and policy implications and without a deliberative legislative process. As existing law requires, the DPA and employee groups should complete MOUs in time for the Legislature to consider the MOUs during the annual budget process. If, however, the DPA and employee groups do not meet this time-frame, there is no urgency that would require the Legislature to forego a full and careful review of the MOUs. Lacking new MOUs, state employees and operations can continue to function during the time it takes for the Legislature to undertake an appropriate review of proposed MOUs.

In order to assure the Legislature has the opportunity to appropriately review new MOUs, we recommend that the Legislature adopt the following policies:

- Review the administration's MOU proposals (including final text and complete fiscal estimates) in the budget hearings and adopt, as appropriate, in the Budget Act. Any MOU that is not available in time for in-depth review during budget hearings, should be referred to the budget committees and adopted, as appropriate, as an amendment to the Budget Act.
- Require a minimum time period between submittal of the proposed MOUs to the Legislature and hearings on the proposal. This would give the Legislature sufficient time to study the MOUs to assure that the fiscal and policy implications of the

proposals are fully understood. Given the importance of these agreements, we suggest a 30-day review period.

For collective bargaining agreements in future years, we recommend that the Legislature enact legislation incorporating the above policies into statute. This legislation also should require that the administration provide the Legislature (and specifically, the fiscal committees) with the text, justification, and fiscal estimates for any amendment or side letter entered into by the DPA and employee representatives after the Legislature has approved an MOU. This change is needed to close a reporting gap in existing law that results in the Legislature not having up-to-date versions of MOUs.

Budget Indicates Changed Policy on Funding Current-Year Pay Increase

The administration intends to authorize departments to spend at rates that would create appropriation deficiencies ($1.7 million General Fund, $28.9 million other funds) in the current year for costs associated with the January 1, 1995 employee pay increase. This proposal should be submitted to the Legislature through separate legislation rather than through a notification process.

As discussed above, most state employees received a 3 percent pay increase on January 1, 1995. The 1994 Budget Act (Item 9800) provided $66 million in additional funds for this purpose only for certain departments directly engaged in public safety, 24-hour care, or revenue-producing activities. As a result, most state departments had to absorb the associated costs. The 1995-96 Governor's Budget, however, indicates that the administration intends to change this policy mid-way through the current year, by allocating an additional (1) $28.9 million (special funds) to *all* non-General Fund programs and (2) $1.7 million (General Fund) to the Attorney General, regardless of the functions or activities of the departments. Department of Finance staff indicate that these augmentations will be proposed through deficiency notification letters to be sent to the Legislature under Section 27.00 of the 1994 Budget Act. One such letter, pertaining to the Attorney General request, was sent January 10.

In our view, the use of Section 27.00 to authorize departments to incur a deficiency is not appropriate when the spending increase is for a purpose not authorized in the original appropriation. Instead, these types of augmentation should be submitted to the Legislature for consideration in separate legislation prior to incurring the added costs.

Changes in Pay-for-Performance Policy

Since last year's introduction of pay-for-performance for managers in civil service, the DPA has revised program details and extended coverage to supervisors in civil service. Furthermore, the Governor has directed the DPA to try to extend pay-for-performance to rank-and-file workers through current collective bargaining negotiations.

In December 1993, the Governor announced a new compensation policy for managers in state civil service. Instead of receiving a 5 percent cost-of-living adjustment (COLA) pay increase scheduled for January 1, 1994, managers would receive pay increases of *up to* 5 percent, provided the department certified that the manager was performing successfully. Without this certification, managers would receive *no* increase. Thus, the policy transformed a pay increase originally intended as a COLA into a "pay-for-performance." The policy left unchanged the receipt of so-called "merit salary adjustments" (MSAs). At the time, the Governor also expressed his intent to extend the pay-for-performance policy to state supervisors for the 3 percent COLA scheduled for January 1, 1995, and thereafter to rank-and-file employees (through collective bargaining).

After the Superior Court in Sacramento County invalidated the specific proposal pertaining to managers (on grounds that the state Administrative Procedure Act had not been followed), the DPA revised the proposal and adopted implementing rules pursuant to the Administrative Procedure Act. These rules apply to managers *and supervisors* in the civil service (including career executive assignments) and in the state special schools. For the 1994 pay increase, the rules retroactively increase manager salary ranges and provide that managers receive either a 5 percent increase, based on certified successful performance, or no increase. For 1995 and future years, the rules transform both the COLA *and* MSAs to a pay-for-performance basis. For January 1, 1995, the rules provide that manager and supervisor salary ranges will increase by another 3 percent. To illustrate how the new rules work, we discuss below how salary ranges, steps and MSAs have worked in the past and under the new rules.

Generally, salary ranges consist of five pay steps, starting with a minimum pay rate, and increasing 5 percent for each succeeding step. On the anniversary date of an employee's appointment to a position, the employee receives—assuming satisfactory performance—an MSA placing him or her on the next step. Under a typical progression, an employee would reach the highest step in four years. Thereafter, the employee would not receive an MSA, unless promoted to another position where the step progression would start anew. A COLA increase raises each pay step in the salary range by the amount of the COLA, automatically increasing every employee's pay.

Under pay-for-performance for managers and supervisors, the MSA process is essentially unchanged, and a COLA increase still raises the steps in the salary range by the amount of the COLA. The key difference is that not everyone's pay automatically goes up by the COLA. A manager/supervisor would not receive the COLA unless he or she had received a favorable performance evaluation. Thus, in the current year, a successful manager/supervisor received the combined effect of an MSA increase (5 percent) and the COLA (3 percent in 1995). For successful managers/supervisors already at the top step, the increase was 3 percent. Managers/supervisors judged unsuccessful received no increase (with the exception of those at the *bottom* step, who received the 3 percent increase in the minimum of the range). Thus, under the new policy, unsuccessful performers "fall down" the salary range (unless they are on the bottom step already).

The *Governor's Budget Summary* states that the administration will try to extend pay-for-performance to rank-and-file employees through collective bargaining agreements with employee representatives.

Disappointing Results from Manager/Supervisor Reductions

In the 1994 Budget Act the Legislature adopted the Governor's proposal to reduce the numbers of managers and supervisors by a statewide average of 10 percent, and reflected the administration's estimated savings of $150 million ($75 million General Fund) for 1994-95. The administration's implementation of this proposal, however, has resulted in only a $4 million savings from all funds ($1 million from the General Fund).

In his 1994-95 budget, the Governor proposed reducing the number of managers and supervisors in state government by a statewide average of 10 percent. His budget assumed that $150 million ($75 million General Fund) would be saved in 1994-95 as a result, but did not allocate the savings to departments. The budget, however, did count the $75 million of unidentified General Fund savings toward the General Fund balance.

To make this proposal operational, the Legislature included Control Section 3.85 in the Budget Act. The control section directed the Department of Finance to allocate appropriation reductions to departments totaling $150 million, reflecting savings from reductions in managers and supervisors.

As a budget-cutting exercise, the manager/supervisor reduction was a failure. The budget indicates that about $4 million was saved from all funds. Of an expected $75 million General Fund savings, only $1 million materialized. In fact, savings in federal funds ($870,000) almost equaled the General Fund total. Moreover, the above totals reflect *gross*, not *net*, effects of departmental actions. For example, the Department of Motor Vehicles (DMV) eliminated 20 vacant supervising motor vehicle representative (SMVR) positions and 12 other positions for current-year savings of $973,000. The DMV, however, plans to *promote* all 61 remaining SMVR incumbents to Manager I positions at a current-year cost of $222,000. Thus, in this case, the savings shown for Control Section 3.85 are overstated by $222,000. It is not clear whether or not similar overstatements have occurred in other departments.

DEPARTMENTAL ISSUES

OFFICE OF EMERGENCY SERVICES (0690)

The Office of Emergency Services (OES) coordinates emergency activities necessary to save lives and reduce losses from disasters. The OES further acts as the state's conduit for federal assistance related to recovery from disasters.

The budget proposes $1.5 billion in total expenditures in 1995-96. This is an increase of $456 million, or 43 percent, over estimated 1994-95 expenditures.

Support Budget. Of the $1.5 billion total budget proposed for OES, $63.2 million is for direct support of the office. This includes $15.1 million from the General Fund, $35.2 million from federal funds, and the remainder ($12.9 million) from various other funds and reimbursements. The amount proposed for direct support is approximately $13.1 million, or 17 percent, less than estimated current-year expenditures; however, when compared to actual 1993-94 expenditures of $35 million, the proposed budget for direct support reflects an increase of $28 million, or 80 percent, over the course of two fiscal years.

Local Assistance Budget. In addition to direct support costs, the budget includes $1.4 billion for local assistance to pay claims from previous disasters. This is $469 million, or 48 percent, more than estimated current-year expenditures for local assistance. The amount proposed for local assistance in the budget year includes $1.4 billion from federal funds, $11.8 million from disaster assistance accounts,

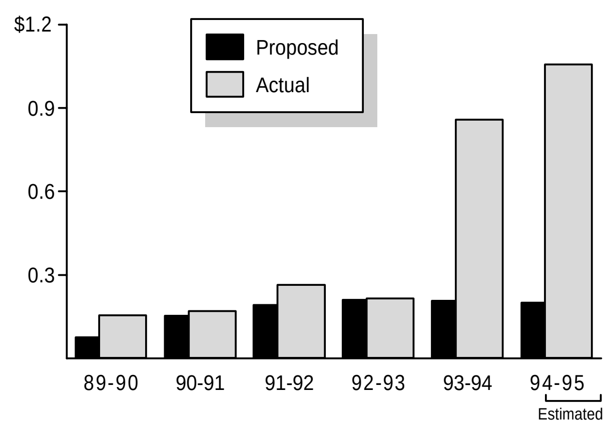
$75 million from the General Fund, and $1.7 million from the Nuclear Planning Assessment Special Account.

Proposed Budget Subject to Major Revision. The amounts proposed for support and local assistance are likely to change significantly given the damage resulting from the recent statewide floods and the historical experience of actual expenditures exceeding budgeted amounts, as shown in Figure 11. The variation between budget and actual expenditures is due to the costs of unanticipated major disasters.

Figure 11

Actual OES Expenditures Compared to Proposed Budgets 1989-90 Through 1994-95

(In Billions)



Proposed Budget Tops $1 Billion. The recent string of disasters in California has resulted in a dramatic increase in the amount of funds flowing through the OES budget, with federal funds constituting the major portion. For 1995-96, OES' expenditures are proposed at approximately $1.5 billion, with the General Fund share being about $90 million. The OES may spend considerably more than the $1.5 billion, because the extensive statewide flooding which occurred in January 1995 will result in substantial costs not contemplated when the 1995-96 budget was prepared.

Substantial Growth Difficult for Any Organization. In addition to having to cope with a dramatic change in the amount of funds which the

OES administers, the office has also had to deal with a substantial growth in the number of staff it must supervise and manage. In 1992-93, the OES had 292 authorized positions. In 1995-96, the budget proposes 637 positions, an increase of *118 percent* over a three-year period.

OES' technology infrastructure has also expanded significantly. In addition to hundreds of computers which have been purchased, the office has also acquired a satellite communication system and has invested heavily in sophisticated Geographic Information System (GIS) resources. These have been expensive undertakings which, as noted below, have been layered on top of an information technology (IT) foundation which has not been well-defined and which is acknowledged to have shortcomings.

Budget Proposes Substantial Growth in Staff

We withhold recommendation on $20.2 million proposed to establish 350 positions for ongoing assistance to the public for disasters and administrative services, pending further review of the basis for the proposed increase and the OES' plan to use information technology to reduce the need for personnel resources.

The budget includes $19.8 million to establish 340 limited-term positions to continue various assistance activities to the public related to recent disasters, primarily the Northridge earthquake, but also going back to the Loma Prieta earthquake. According to the OES, these positions would replace emergency or temporary staff which the office has had to hire to respond to the demand for services created by recent disasters. The budget also includes $416,000 to establish ten new permanent administrative positions which the office says are necessary to manage increased OES staffing and related workload attributed to the Northridge earthquake.

We have two concerns with the proposal. First, we have been unable to determine whether the proposed new positions are justified on a workload basis due to the lack of information from the OES. Second, the OES acknowledges that a lesser number of positions would be necessary if the office made more effective use of IT to provide assistance to the public, but it is not clear whether the office has a firm plan to do so.

For these reasons, we withhold recommendation pending further review of the basis for the request.

New Funds for Disaster Costs Need Further Justification

We withhold recommendation on $75 million requested to pay for local disaster costs, pending receipt of additional justification for the proposal.

The budget includes $75 million from the General Fund to pay the state's share of local government costs associated with disasters other than the Northridge earthquake. These disasters include the Loma Prieta and Humboldt County earthquakes, southern California and Oakland fires, Los Angeles riots, and 1992 winter storm damages. While we acknowledge that the OES will be obligated to make *some* payments in 1995-96 to cover these costs, the OES has not provided sufficient detail to validate the need for the amount requested. Thus, we withhold recommendation on $75 million requested to pay the state's share of local disaster costs pending further review of additional information on the basis for the proposal.

Independent Review of the OES Is Needed

We recommend the adoption of supplemental report language requiring the Office of Emergency Services to contract with the Bureau of State Audits to (1) conduct a thorough fiscal and performance review of the OES and (2) make recommendations which, if implemented, will improve the office's administrative effectiveness.

We discuss below several aspects of the administration of OES which we believe indicate the need for a thorough review of the office's fiscal and program operations in order to determine ways to improve its effectiveness. In recommending this review, we recognize the challenging task the OES has had in recent years to cope with the increased frequency of major disasters and the burden that this response has placed on the OES' administrative systems. It is because of the challenge this burden represents that we conclude a thorough review is warranted.

Concerns Identified With OES' Operations. In the past few years, both the Legislature and the Department of Finance (DOF) have identified the need for changes in the manner in which the OES administers its programs. The DOF's views are contained in *A Program Review of the Office of Emergency Services* which was published in May 1992. The DOF's report listed ten problem areas which are summarized in Figure 12.

Figure 12

Problems With OES Operations Identified by the Department of Finance May 1992

- ✔ Inadequate internal and external coordination which resulted in a duplication of effort and impacted local government's ability to work with state agencies on disaster matters.
- ✔ Lack of support for local emergency managers in overcoming local resistance to maintenance, preparedness, and planning during periods between disasters.
- ✔ A confusing organizational structure which adversely affected communication with local agencies.
- ✔ Unequal distribution of resources among OES units which resulted in some programs being more able than others to serve the public.
- ✔ Lack of uniform, networked computer resources which worked against efforts to improve communication and coordination.
- ✔ Administrative practices which impeded managerial effectiveness (for example, not providing managers program expenditure information on a timely basis).
- ✔ Confusion as to the roles of state and local emergency operations centers which resulted in duplication of effort in some emergencies.

In summary, the DOF report concluded that:

- Management had failed to deal adequately with problems of communication, coordination, duplication, and cohesiveness.
- The OES was organized in a manner which did not enhance its work.
- Inefficient administrative services, a lack of appropriate computer capability, and an unequal distribution of resources left some units confused about their responsibilities, guarding their assets, or duplicating other units.

A memorandum from the Director of the OES to the DOF expresses concurrence with the general conclusions contained in the DOF report, and further notes that the conclusions are consistent with findings of OES' own internal review.

Extent of Improvement Unknown, but Problems Persist. The extent to which the OES has successfully resolved the problems cited in the DOF's May 1992 report is not known. At the same time, at least one of the more significant problems identified by the DOF, the lack of an appropriate information technology infrastructure, has not been resolved.

The OES does not have a *plan* for IT yet the office is becoming increasingly dependent on IT to carry out its responsibilities. Like many state agencies, the OES has a variety of computers and software. Without a plan, continued expenditures for additional IT capability will only add to the already unsatisfactory situation which the DOF noted in its 1992 review. The OES estimates that it will have spent $10.7 million on computer equipment during the period 1991-92 through 1995-96, out of total IT expenditures of at least $28 million for that same period. The budget proposes an additional $7.4 million in 1995-96 for IT projects including a new management information system which is being developed without the benefit of a Feasibility Study Report as required by state policy. (This is because the OES often uses emergency exemption authority in taking actions which would ordinarily require a more structured process with checks and balances.)

Legislative Concerns. Over the last several years, the Legislature has expressed its desire for improvements at the OES. For example, in conjunction with the enactment of several Budget Acts, the Legislature has adopted supplemental report language that directs OES to:

- Report, on a quarterly basis, support and local assistance expenditures for disaster-assistance costs, revenues to pay for these costs, and transfers to disaster assistance accounts.

- Improve its dissemination of disaster assistance information to victims, the Legislature, and the media.
- Address its information technology needs.

Unsatisfactory Response to Legislative Direction. The OES' responsiveness to the supplemental report language adopted by the Legislature has been unsatisfactory. For example, supplemental language adopted in 1993 requires the OES to report to the Legislature quarterly regarding support and local assistance expenditures for disaster assistance costs and other fiscal information. In last year's *Analysis*, we noted that the initial report, due October 1993, had not been issued at the time our analysis was prepared. Subsequent reports due at the end of December 1993 and March 1994 were not provided to the Legislature until January 18, 1995.

Additional Concerns. In addition to the concerns raised earlier, the effectiveness of some recent large expenditures is unclear. For example, the Budget Act of 1990 provided $3.9 million to procure and implement a statewide emergency communications system which was to include 84 remote satellite stations. The system was to be designed to survive a large scale disaster such as a catastrophic earthquake. According to the OES, $7.7 million was expended to complete the system, and annual maintenance and other costs total about $1 million. Given the increased cost of the system and the importance attached to the system by the Legislature when it appropriated the initial funding in 1990, it would be useful to know whether the investment has produced the intended benefits. Similarly, it would be helpful to the Legislature to know whether $48.5 million expended for consultant contracts in 1993-94, with all but two of the 20 contracts awarded to a sole bidder under emergency or other bidding exemptions, represented the best value the state could obtain given the circumstances.

Emergencies Should Not Be Used as an Excuse. The OES frequently uses the fact that it has to deal with emergencies as an explanation for not complying with state policy or legislative direction. In fact, the OES is given broad exemption from routine state law and policy governing such activities as contracting, the hiring of personnel, and the approval of IT projects, because the OES needs to be able to respond quickly to emergencies. At the same time, OES' reason for existence is to deal with emergencies, and like any other emergency-oriented entity (such as law enforcement and fire protection), it needs to effectively perform day-to-day administrative tasks. Moreover, while administrative systems may be affected during an emergency, this should only be temporary and should not be an excuse for not complying with legislative direction.

Under the disaster "umbrella," the OES has the kind of administrative flexibility that departments participating in the Governor's performance budgeting pilot are striving for through their annual budget contracts with the Legislature (please see our analysis on this issue in the Crosscutting Issues section of this chapter). Unlike the pilot departments, however, the OES does not have a strategic plan and has not been required to develop performance measures so that the administration and the Legislature can each determine the outcomes of the office's program efforts.

A Review Can Help the OES. Based on the recent history of administrative problems within the OES, we believe that a comprehensive fiscal and performance audit of the OES' administrative operations is warranted. We believe that such an audit will be especially useful given decisions to establish a greatly expanded work force and the associated administrative and technological infrastructure. The audit should help the OES to improve the organizational foundation upon which its program areas depend to carry out their important missions, thereby enabling the program areas to be more effective. A thorough fiscal and performance review would not only provide the OES valuable information, it should also help the Legislature to obtain a better understanding of the value received for the many investments it has authorized OES.

For these reasons, we recommend that the Legislature adopt the following supplemental report language:

> The Office of Emergency Services (OES) shall contract with the Bureau of State Audits for a comprehensive fiscal and performance audit of the OES, in order to develop recommendations which, if implemented, will improve the OES' administrative operations and information technology infrastructure so as to enable the OES to operate more effectively in addressing recent and future disasters. The audit shall specifically encompass (1) fiscal control, accountability, reporting and compliance with state law and policy, (2) contracting practices, including compliance with state law and policy, effectiveness of contract management, and the extent to which procurement alternatives are explored and contract awards are appropriate and the most efficient and effective procurement method is employed, (3) extent of compliance with state law and policy regarding the hiring and assignment of personnel, including temporary and emergency hires, and whether hiring and staff assignments represent the most efficient and effective use of resources, (4) organizational effectiveness, (5) an assessment of the adequacy of the OES' administrative support infrastructure, including information technology planning and capability, and (6) the performance of the office in carrying out its various statutory responsibilities. The State Auditor may employ external consultants in conducting the audit required by this provision. The OES shall reimburse the State Auditor fully for all expenses incurred in the performance of the audit required by this provision, in an amount not to exceed $200,000. The Bureau of State Audits shall report its findings and recommendations to the OES and the Legislature by March 15, 1996.

STATE CONTROLLER (0840)

The State Controller is responsible for (1) the receipt and disbursement of public funds, (2) reporting on the financial condition of the state and local governments, (3) administering certain tax laws and collecting amounts due the state, and (4) enforcing unclaimed property law. The Controller is also a member of various boards and commissions, including the Board of Equalization, the Franchise Tax Board, the Board of Control, the Commission on State Mandates, the State Lands Commission, the Pooled Money Investment Board, and assorted bond finance committees.

The Governor's Budget proposes expenditures of $107.5 million ($65.3 million from the General Fund) to support the activities of the State Controller in 1995-96. This reflects an increase of $2.3 million, or 2.2 percent, above estimated current-year expenditures.

Basis for Additional Audit Activity Is Unclear

We withhold recommendation on $501,000 and seven positions proposed to conduct audits, pending review of a revised proposal.

The budget includes $501,000 from the General Fund, and seven positions for the State Controller to conduct performance audits. According to the Governor's Budget document, these positions are to be used to conduct audits pursuant to the provisions of the State Government Strategic Planning and Performance Review Act (Ch 779/94, AB 2711, Valerie Brown). However, the Controller's Office advises that the positions will be used to perform audits *independent* of those required under Chapter 779. (The Controller's Office also indicates that it is preparing a separate budget proposal for submission to the Legislature describing how the positions will be used.) Consequently, it is unclear whether these positions will be used for performance audits pursuant to Chapter 779 or not. Therefore, we withhold recommendation on $501,000 and seven positions to conduct these audits, pending review and analysis of the revised proposal.

STATE BOARD OF EQUALIZATION (0860)

The Board of Equalization (BOE) is one of the state's major tax collection agencies. It collects state and local sales and use taxes and a wide variety of business and excise taxes and fees, including those levied on gasoline, diesel fuel, cigarettes, and hazardous wastes. The BOE also oversees the administration of the property tax by county assessors and assesses property owned by public utilities. The BOE is also the final administrative appellate body for personal income and bank and corporate taxes, as well as for the taxes it administers.

The budget proposes expenditures of $282.1 million ($169.5 million General Fund) for the BOE in 1995-96. This total is nearly 5 percent more than estimated current-year expenditures. About 25 percent of the increase is attributable to the development and acquisition costs of an automated system to accelerate the collection of delinquent taxes.

BOE Computer Migration Cost Overruns

We recommend that the BOE report to the Legislature during budget hearings on how the computer redesign and migration bidding process met state competitive bidding requirements and how the award of the contract at $9.6 million (155 percent) over the BOE's estimate, was beneficial to the state.

The BOE is in the process of moving its data processing systems from an in-house operation to the Stephen P. Teale Data Center (TDC). The justification for this effort is that the board would (1) administer its tax programs more effectively, (2) absorb increases in workload more efficiently, and (3) eliminate the costs associated with managing its own mainframe computer. The project, which began in 1991-92, was originally estimated to take 5 years and cost $30 million to complete. In November 1992 the timetable for completing the project was extended by a year to 1996-97. The BOE's current timeframe and cost estimate indicates that the project will not be completed until the end of 1997-98 at a cost of $47.3 million, or 58 percent higher than the original estimate.

In September 1993, the BOE indicated that in-house staff lacked the expertise to complete the migration, and that the scope of the project would have to be curtailed and the timetable for completion would have to be pushed back by at least a year unless the project cost was increased by $6.2 million. Consequently, the Governor's 1994-95 Budget increased the project cost to keep it within scope and on schedule.

The Legislature approved the augmentation and added budget language directing the BOE (1) to contract with a private consultant to provide project management expertise and (2) to contract for any services the BOE deemed necessary to oversee the management contract to assure a successful project. When the BOE originally estimated the cost for the consultant services, there was the expectation that at least three firms would bid on providing the management services. When the BOE received the bids, however, only one bid was received from a joint venture of three consulting firms. Consequently, competitive bids were not received for this proposal. This bid totaled $15.8 million—$9.6 million (155 percent) over the BOE's estimate. Even though the bid was not competitive and was significantly higher than the BOE's estimate of the value of the services, the BOE awarded the contract on October 13, 1994, and the consultant began working November 1, 1994. The BOE explains that it accepted the bid because rebidding the project would not have changed the outcome and because the only other option would have been to discontinue the project.

To cover the $9.6 million cost overrun, the BOE first reduced the size of the contract by $700,000 by eliminating "non-essential" functions in the contract. It proposes to pay for most of the remainder by redirecting $6.4 million in other budgeted project costs. The BOE, however, indicates it will seek a $2.5 million augmentation in 1996-97 to make the final payment to the vendor.

Our analysis indicates that the BOE had a number of options available to it: (1) rebid the proposal with the intent of meeting competitive bidding requirements, thereby reducing the amount of the contract through competition; (2) rebid the proposal after advising the Legislature of the need for an augmentation and why the original cost estimates were significantly underestimated; (3) accept the bid and absorb the cost differential; or (4) delay accepting the bid until the necessary funding was approved by the Legislature.

The BOE, however, chose to accept the bid it received and is planning to seek an augmentation in 1996-97 to cover the cost overrun. By accepting a bid and signing a contract significantly higher than budgeted, the BOE in effect certified that funds were available to pay for the contract. We do not believe it is a desirable precedent or prudent policy to allow departments to enter into contracts that obligate the Legislature to future appropriations. Consequently, we believe the Legislature should not provide an augmentation in 1996-97.

Therefore, we recommend that the BOE report to the Legislature at budget hearings on how the bidding process met the state's requirement for competitive bids and how the award of such a single bid was beneficial to the state.

MSAs and Other Price Increases

We recommend that the Legislature not approve a $4.2 million augmentation associated with Merit Salary Adjustments (MSAs), employer retirement rate contribution adjustments, and postage rate increases, unless the BOE demonstrates that these cannot be absorbed within discretionary portions of the budget that do not directly affect tax revenues.

In preparing the 1995-96 Governor's Budget, the Department of Finance instructed all state departments not to include funding for the costs of merit salary adjustments and operating expense price increases within their baseline funding levels. The BOE and the Franchise Tax Board, however, have been granted exemptions from this policy. The BOE justifies its exemption on the basis of potential annual revenue loss of $20.8 million that the BOE claims would occur if resources were redirected from other activities. The BOE reaches this revenue loss figure on the basis that most of the redirection necessary to pay for the baseline adjustments would directly affect revenue collecting activities such as auditing. The BOE claims that foregone revenue collecting activities would cost the state $4.90 for every $1 that is redirected.

Our analysis indicates that the BOE may have the ability to absorb these costs, like other state departments, without having any effect on tax collections. The BOE has the discretion for making these adjustments by decreasing expenditures in areas such as operating expense and equipment, without affecting revenue collecting activities. For example, the BOE's operating expense and equipment budget is proposed to be $73.6 million in the budget year and includes expenditures such as $3.2 million for in-state travel, $3.1 million for out-of-state travel, and $4.7 million in general expenses.

The Legislature has typically exempted the BOE from policies such as absorbing MSA and operating expense increases. This exemption has been based on the BOE tax collecting activities. The BOE maintains that, as mentioned above, redirection of funds in the BOE budget results in a loss of about $5 for every $1 that is redirected. While there is some justification to this approach, it does not necessarily hold true for all of the BOE's expenditures. As discussed above, some of the BOE spending is of a discretionary nature that is not directly related to tax revenues. These expenditures could be reduced to absorb the MSAs and other increases. Consequently, we recommend that the Legislature not approve the

$4.2 million augmentation unless the BOE demonstrates that these costs cannot be absorbed through the reduction of expenditures in areas that do not directly affect tax revenues.

SECRETARY OF STATE (0890)

The Secretary of State, a constitutionally established office, has statutory responsibility for examining and filing financial statements and corporate-related documents for the public record. The Secretary, as the chief elections officer, also administers and enforces election law and campaign disclosure requirements. In addition, the Secretary appoints notaries public, registers auctioneers, and manages the state's archival function.

The budget proposes total expenditures of $45.9 million for the Secretary of State in 1995-96. This is $708,000, or 1.6 percent, more than current-year expenditures. Expenditures from the General Fund total $19.6 million, a decrease of $1.9 million, or 9 percent, compared to these expenditures in 1994-95. Expenditures were greater for 1994-95, primarily because of the costs of the November 1994 general election. Expenditures from the Secretary of State's Business Fees Fund are projected to be $20.7 million in 1995-96, an increase of $3.7 million, or 22 percent, over current-year expenditures, due to added costs related to moving into the Secretary of State's new building.

Significant Changes to Information Technology Management

The Secretary of State has prepared an Agency Information Management Strategic Plan to improve its information technology services. Implementation of the plan is currently estimated to cost $14.2 million over a five-year period.

The budget requests an increase of $2.5 million for information technology-related activities. The request includes:

- Establishment of 14 positions to improve and upgrade information technology in the Secretary of State's office. The budget proposes to use the 14 new staff and 11 existing positions to create a new Information Technology Division. Currently, the Secretary of State's information technology staff report to the Management Services Division.
- Funding for support of the data communications network installed in the Secretary of State's new building in Sacramento (the

new building is near completion and is scheduled for occupancy later this year).

Background. The Secretary of State's seven functional divisions each have unique and varied information technology requirements. For example, the elections division requires automated systems to tabulate the vote from all 58 counties on elections night and to complete the official canvass that results in the certified *Statement of the Vote*. The Corporate Filings and Services Division operates three different systems that track corporate paper filings and provide corporate information to the public. Each division operates different computer applications. The applications run on a variety of systems, ranging from Teale Data Center mainframe computers to personal computers. Some include manual systems.

History of Information Technology Problems. In a detail submitted to support its budget proposal, the Secretary of State's office characterized itself as having an "erratic" record of success regarding information technology. The problems include:

- An optical imaging system for the Uniform Commercial Code (UCC) that failed and had to be abandoned.
- A UCC Online Filing system to allow users direct access to data on California corporations, which was delayed on several occasions.
- A campaign filing system that has 83 different programs using several different computer systems, that requires some data to be handled manually.
- Systems that are antiquated, some more than 20 years old.
- A wide variety of systems that are not well-integrated throughout the agency.

Completion of a Strategic Plan. The Secretary of State issued its *Agency Information Management Strategic Plan* in October 1994. The plan acknowledges the problems the office has faced in maintaining and improving its information technology systems. It includes an overview of each division's system weaknesses and contains a plan for improving both applications and information infrastructure. The plan also recommends increased staffing in a new organization. The plan's recommendations for staffing and reorganization form the basis for the current- and budget-year increases.

Our analysis indicates that the plan is comprehensive, identifies weaknesses in the current system, and lays out goals for addressing these weaknesses. The plan contains proposed projects and schedules for improving the Secretary of State's information technology environment over the next five years (1994-95 through 1998-99). The total costs are projected to be $14.2 million over the five-year period. This includes the costs of new staffing in both the current and budget years which are proposed to undertake detailed planning and to implement systems for the new building. We anticipate that the office will request, as part of future budget proposals, legislative authorization for the other portions of the plan.

Technical Issue: Inappropriate Expenditure From the Business Fees Fund

We recommend that the Election's Division investigation unit be funded from the General Fund rather than the Business Fees Fund because the Business Fees Fund is an inappropriate source of appropriation for the unit. (Reduce Item 0890-001-228 by $201,000 and augment Item 0890-001-001 by $201,000.)

Chapter 1059, Statutes of 1991 (SB 563, Alquist), established the Secretary of State Business Fees Fund. All business fees collected by the Secretary of State, with the exception of fees collected pursuant to the Political Reform Act of 1974, are deposited in the Business Fees Fund. Prior to Chapter 1059, these fees were deposited into the General Fund. These monies are to be used to support the programs for which the fees are collected. Fees are to be sufficient to cover the costs of these programs. Any fees collected in excess of those needed for support are transferred to the General Fund. The Governor's Budget estimates that $4.2 million will be transferred to the General Fund at the end of the current year and that $2.6 million will be transferred at the end of the budget year.

Last year, the Acting Secretary of State asked the Legislature to establish a unit in the Elections Division to investigate voter fraud. The Legislature appropriated $162,000 from the Business Fees Fund to support the unit, and a current-year deficiency provided an additional $59,000 to further support the unit. The proposed budget for 1995-96 requests $201,000 from the Business Fees Funds to continue the unit.

Our review indicates that the unit has no responsibilities for business-related programs, and supporting the unit from the fund is inconsistent with the statutory requirements contained in Chapter 1059. Thus, we recommend that the unit be funded, instead, from the General Fund. This action will not result in any net loss to the General Fund because the $201,000 from the Business Fees Fund will be transferred to the General Fund at the end of 1995-96. (Reduce Item 0890-001-228 by $201,000 and augment Item 0890-001-001 by $201,000.)

STATE TREASURER (0950)

The State Treasurer has a number of responsibilities related to the management of the state's financial assets. These responsibilities include:

- Providing custody for all money and securities belonging to or held by the state.
- Investing temporarily idle funds.
- Paying warrants and checks drawn by the State Controller.
- Preparing, selling, and redeeming the state's general obligation and revenue bonds.
- Preventing the issuance of unsound securities by irrigation, water storage, and certain other districts.

The Governor's Budget proposes expenditures of $16.4 million ($5 million from the General Fund) to support the activities of the Treasurer's Office in 1995-96. This is essentially the same level of expenditure for the current year.

Consolidation of Financial Authorities and Other Financial Bodies

We recommend that the Treasurer provide the Legislature, at the time of budget hearings, a plan to consolidate various financial entities in order to reduce costs without compromising service.

In 1994, both the Governor and the Treasurer proposed the elimination and/or consolidation of several financial authorities, commissions, and committees. While the specifics of each proposal varied—the Governor's proposal was more extensive—there were some common points of agreement. For example, both proposed to consolidate many of the same financial authorities—for instance, the California Debt Advisory Commission (CDAC). Both proposals promised annual ongoing savings without compromising service. The Governor's proposal estimated full-year savings of $2.2 million, based on the elimination of 27.3 personnel-years. The Treasurer's plan would have eliminated 11 personnel-years, generating annual savings in excess of $1 million dollars. Both plans would have required legislation to implement. Although bills were introduced to achieve consolodation, the 1994-95 budget was approved with neither plan being adopted.

Entities Considered for Consolidation. Figure 13 displays financial entities considered for consolidation.

Figure 13

Financial Entities Considered for Consolidation

(Dollars in Thousands)

	Positions	1995-96 Budget	Year Authorized
Industrial Development Financing Advisory Commission	3	$431	1980
Alternative Energy and Advanced Transportation Financing Authority	1	172	1980
Pollution Control Financing Authority	11	1,779	1972
Health Facilities Financing Authority	12	1,698	1979
Urban Waterfront Area Restoration Financing Authority	1[a]	—	1983
School Financing Authority	2	156	1985
Educational Facilities Authority	2	349	1976
Debt Limit Allocation Committee	4	414	1984
Tax Credit Allocation Committee	14	1,846	1981
Debt Advisory Commission	13	1,373	1981
Passenger Rail Financing Authority	1[a]	—	1982
Student Loan Authority	3	246	1980
Totals	**67**	**$8,464**	

[a] Authorized but not filled.

These entities, each funded through fees, are authorized to perform a wide range of functions, ranging from the administration of federal and state low-income housing tax credit programs (California Tax Credit Allocation Committee) to the selling of bonds to facilitate urban waterfront development projects within designated areas (California Urban Waterfront Area Restoration Financing Authority). The ability of certain of the financing authorities to sell tax exempt bonds is affected by federal tax law which limits the amount of such bonds that can be sold annually, and the California Debt Limit Allocation Committee allocates sales of tax exempt bonds to the various financing authorities in compliance with this law.

Conceptual Agreement Suggests Savings Are Still Possible. We believe that there is merit in assessing the feasibility of eliminating the various financial entities shown in Figure 13 and consolidating their functions into the Treasurer's Office. For example, consolidation of the CDAC into the Treasurer's Office would ensure accountability in a specific entity (the Treasurer), maintain the debt advisory function, and take advantage of economies of scale to save money.

Although the Governor's proposed budget for 1995-96 does not include a consolidation proposal, we believe that the 1994 proposals from both the Governor and the Treasurer indicate that consolidation is possible and can produce savings without compromising service. On that basis, we recommend that the Treasurer provide the Legislature, at the time of budget hearings, his plan to produce savings through the consolidation of financial authorities and other financial bodies.

FRANCHISE TAX BOARD (1730)

The Franchise Tax Board (FTB) is one of the state's major tax collection agencies. The FTB's primary responsibility is to administer California's Personal Income Tax and Bank and Corporation Tax. The FTB also administers the Homeowners' and Renters' Assistance programs and the Political Reform Act audit program. The FTB consists of the Director of Finance, the Chair of the State Board of Equalization, and the State Controller. An executive officer is charged with administering the FTB's day-to-day operations, subject to supervision and direction from the board.

The budget proposes expenditures of $324.2 million ($309.9 million General Fund) in the budget year, a 9 percent increase over estimated current-year expenditures. Over 80 percent of the increase is attributable to the proposed cost of procuring a new Bank and Corporations Tax collection computing system.

Computer Procurement Paid for Out of Increased Tax Revenue

The FTB is purchasing a new Bank and Corporation Tax computing system out of anticipated increased revenue collections attributable to the new system. Given the potential financing risks to the state under this method of paying for the system, we recommend that the FTB report annually to the Legislature on the amount of additional tax revenue collected, and the status of debt repayment.

The FTB is in the process of purchasing a new computing system for collection of bank and corporation taxes. The FTB redirected $1.4 million in 1993-94 to initiate the project. Appropriations for the first two components of this system were approved in the 1994 Budget Act. To fund the $13.6 million cost associated with the new system in 1994-95, the FTB redirected information technology funds, and received a $7.9 million General Fund augmentation. The FTB proposes to increase this operating base in 1995-96 to $37.2 million—by redirecting an additional $1.1 million and requesting a $22.5 million General Fund augmentation—to incorporate the third and final element of the system and to pay the vendors.

The FTB expects the new system to be completely paid for in 1998-99. Total expenditures of the six-year effort to complete this system are estimated to be $113 million. Of this amount, $53 million is for services and project deliverables provided by selected vendors. Figure 14 shows total cost (principal and interest) for each element of the procurement. The remaining $60 million is the FTB operating cost for the new system during the six-year period. The FTB estimates that the tax receipts from banks and corporations will increase by $205.3 million over the six years as a direct result of the new system (a net gain of $92.4 million to the General Fund), and will result in increased annual net revenue of $56.7 to the General Fund thereafter. Revenues are projected to increase because the new system integrates all of the FTB's information systems and allows the board to identify returns that have the greatest potential for audit.

Figure 14

Franchise Tax Board
New Tax Collection System for Banks and Corporations

(In Millions)

Redesign Element	Principal	Interest	Total
Business Entity Tax System (BETS)[a]	$22.5	$1.9	$24.4
Collection Account Process System (CAPS)[a]	5.3	0.2	5.5
Pass-Through-Entity Automated Screening and Support (PASS)	22.8	0.6	23.4
Totals	**$50.6**	**$2.7**	**$53.3**

[a] Elements approved in the 1994 Budget Act.

The Legislature approved expenditure authority for the first two components of the new system in the 1994 Budget Act. These components included (1) the Business Entities Tax System (BETS), which is the primary data base for the program, and (2) the Collection Account Process System (CAPS) to help increase FTB collection of outstanding assessments. The proposed budget-year augmentation is for the third project element—the Pass-Through-Entity Automated Screening and Support System (PASS), which will enhance the FTB's audit and enforcement capabilities.

Performance-Based Procurement. The contract for the Bank and Corporation Tax computer system is being done very differently from most procurements of this type. The following is a brief discussion of this contract and the associated state cost implications.

Under the BETS and CAPS repayment plan approved in the 1994 Budget Act, the selected vendors finance all the initial project costs, and do not get paid until the FTB begins to realize the anticipated additional tax revenue from the new system. Under this plan the vendor receives 75 percent of the projected additional annual tax revenues attributable to the new system until the system is paid for. Thus, a vendor does not get paid faster if collections are higher than expected. (The PASS component will be financed in the same manner.) If additional annual tax dollars come in slower than projected, the vendor is paid 75 percent of the *actual* additional amount collected, with the unpaid principal plus approximately 9 percent interest carrying over for payment in a subsequent fiscal year. The repayment schedule and cash flow projection show the project being paid for by 1998-99. If, however, actual revenues fall below the projected amounts, the contract calls for payments to be extended beyond the projected repayment schedule (up to four years longer) to pay the vendor for any unpaid principal plus interest.

Under this payment method, the selected vendor borrows the money to undertake the redesign, and the FTB pays the vendor for service costs, interest costs, plus a profit margin. This method differs from the typical state procurement, where projects are funded up-front with direct appropriations, or through financing incurred by the state. In FTB's procurement, the amount of interest payable to the vendor increases if additional tax revenues do not accrue as projected, thereby increasing the cost of the project. The vendor also has an interest in making sure the project succeeds because repayment ceases past the expiration date of the contract, regardless of how much of the cost remains outstanding.

Under this procurement contract, the state is potentially exposed to interest costs that are significantly higher than if the state had undertaken a short-term borrowing. Figure 14 shows that, based on the projected accumulation of additional tax revenue, the state will incur interest costs of $2.7 million (approximately 9 percent annual interest rate) between the time the redesign is completed and the project is paid off. The actual costs, however, could be significantly higher if the additional revenues do not accrue according to projections and payments to the vendors are paid over an expanded time period. While the state faces a degree of financial risk and higher interest costs, there are also aspects of the contract that help balance this risk. For example, the contract provision that gives the vendor a financial stake in the success of the project is a useful tool for engaging the vendor in a real partnership.

The FTB is tracking bank and corporation tax receipts to be able to separate revenues attributable to the new system from those which would have materialized anyway. Given the potential exposure the state faces if additional tax revenues do not accrue as projected, we recommend that the FTB be required to provide the Legislature with an annual report of additional revenues collected and the amount of debt retired.

Law Requires Child Support Program to Be Funded by Reimbursements

We recommend that the Legislature delete $1 million from the General Fund and increase reimbursement authority by the same amount to fund the expansion of the FTB's child support collection program fully out of county incentive payments and federal reimbursements. (Reduce Item 1730-001-001 by $1 million and increase reimbursements by $1 million.)

Pursuant to Ch 1223/92 (AB 3589, Speier), in December 1993 the FTB instituted a six-county pilot project and began accepting referrals from district attorneys in the participating counties to collect child support payments. In 1994, Ch 906/94 (AB 923, Speier) was enacted requiring the FTB to expand the program statewide.

The budget proposes child support collection program expenditures of $4.8 million in 1995-96. Of this total, $1 million is from the General Fund and $3.8 million is from reimbursements (primarily the federal government). Proposed expenditures represent an increase of $748,000 (18 percent) over estimated current-year expenditures.

Chapter 1223 enacted Revenue and Taxation Code Section 19272, which provides that the child support collection program be funded fully out of county "incentive" reimbursements and federal reimbursements. The federal government distributes reimbursement funds to the Department of Social Services (DSS) based on a percentage of child support payments collected within the state. The DSS is responsible for allocating the federal reimbursement funds. In addition, state law provides that counties be paid incentive payments out of collected amounts to induce counties to actively pursue the collection of child support. There are three components to the incentive payments made available to counties:

- ***Base Rate Incentive Payments.*** These are payments made to all counties. In the current year, counties receive 7 percent of amounts collected. Base rate incentive payments are scheduled to be reduced to 6 percent of amounts collected in the budget year.
- ***Compliance Rate Incentive Payments.*** These are payments made to counties based on whether or not they comply with state and federal regulations. The compliance rate incentive payments are 4 percent in the current year, and 5 percent in the budget year.

- ***Performance Rate Incentive Payments.*** These are payments to counties based on their performance against certain benchmarks. The performance rate incentive payments can be as high as 2 percent in the current year, and 3 percent in the budget year.

Under existing law, the FTB is to be reimbursed for its costs from a portion of the incentive payments that would have otherwise gone to the county. Revenue and Taxation Code Section 19272(c) puts a ceiling on the amount the FTB can receive from the county base incentive rate payments (no more than 50 percent) "provided that state operation costs are recovered from incentive payments or other federal reimbursement." If FTB operational costs exceed the amount available from the base incentive payments, then the law states that the FTB must capture the shortfall from other incentive payments. The FTB, however, proposes collecting reimbursement from counties solely from base rate incentive payments, and make up the additional costs with General Fund augmentations.

Our analysis indicates that even if the FTB limited its collection of incentive payments to the base incentive rate payments, it would have sufficient revenue to fund all its child support collection program costs. The FTB estimates pilot project child support collections of $34 million in calendar year 1994. Even if the FTB collected only $34 million in 1995-96 (a conservative estimate because the six-county pilot project is being extended statewide), the FTB would receive over $1 million from base rate payments alone. In addition, the DSS estimates that if the FTB received reimbursements from the compliance rate incentive payments, an additional $1.3 million would be available to the FTB in 1995-96. Clearly, there is sufficient reimbursement authority available to the FTB and a General Fund augmentation is not necessary.

Consequently, we recommend that the Legislature delete $1 million under Item 1730-001-011 and increase reimbursements by $1 million. This will continue the program activities as planned and fund the FTB operational costs as called for under existing law.

MSAs and Other Price Increases

We recommend that the Legislature not approve a $6.3 million augmentation associated with merit salary adjustments (MSAs), employer retirement rate contribution adjustments, and postage rate increases until the FTB demonstrates that these costs cannot be absorbed within discretionary portions of the budget that do not directly affect tax revenues.

In preparing the 1995-96 Governor's Budget, the Department of Finance instructed all state departments not to include funding for the costs of merit salary adjustments and operating expense price increases within their baseline funding levels. The FTB and the State Board of Equalization, however, have been granted exemptions from this policy. The FTB justifies its exemption on the basis of the potential revenue loss of $47 million in the budget year that the FTB claims would occur if resources were redirected from other activities. The FTB reaches this revenue loss figure on the basis that most of the redirections necessary to pay for the baseline adjustments would directly affect revenue collecting activities (such as auditing).

Our analysis indicates that the FTB may have the ability to absorb these costs, like other state departments, without having any effect on tax collections. The FTB has the discretion to make these adjustments by decreasing expenditures in areas such as operating expenses and equipment without affecting revenue collecting activities. For example, the FTB's operating expense and equipment item is budgeted at $96.9 million and includes expenditures such as $1.8 million for in-state travel, $938,000 for out-of-state travel, and $6.7 million in general expenses.

The Legislature has typically exempted the FTB from policies such as absorbing MSA and operating expense increases. This exemption has been based on the FTB tax collecting activities. The FTB undertakes auditing activities that generally return $5 for every $1 expended, and estimates spending reductions to have a corresponding decrease on state revenues. While there is some justification to this approach, it does not necessarily hold true for all of the FTB's expenditures. As discussed above, some FTB spending is of a discretionary nature that does not directly relate to tax revenues. These expenditures could be reduced in order to absorb these costs. For example, the FTB apparently was able to redirect $4.8 million over the previous two fiscal years to the bank and corporation computing procurement without affecting tax revenues.

Consequently, we recommend that the Legislature not approve the $6.3 million augmentation unless the FTB demonstrates that these costs cannot be absorbed through the reduction of expenditures in areas that will not directly affect tax revenues.

DEPARTMENT OF GENERAL SERVICES (1760)

The Department of General Services (DGS) is responsible for (1) providing a broad range of support services to operating departments and (2) performing management and oversight activities related to support services. It provides these services primarily through two programs: statewide support and property management services.

The Governor's Budget proposes expenditures of $503 million from various funds ($11.2 million from the General Fund) to support the activities of the DGS in 1995-96. This reflects a net *decrease* of $64.8 million, or 11 percent, below estimated current-year expenditures. The primary components of this decrease are (1) transferring the State Police to the California Highway Patrol—$28.2 million, and (2) reducing the baseline budget for local assistance to reflect one-time expenditures of $45 million in 1994-95 for earthquake safety. Of the $503 million, about 23 percent ($116 million) of the department's costs are funded from direct appropriations, with the balance—77 percent ($387 million)—being funded from amounts appropriated to other state entities for payment to the DGS for providing goods and services.

Statewide Support Services. Expenditures for statewide support services are $330 million in the budget year, representing a *decrease* of $28 million, or 7.8 percent, below estimated current-year expenditures. As noted above, this decrease is due primarily to the proposed transfer of the State Police. In fact, the proposed budget for statewide support services includes $12.9 million in *new* spending proposals. These increases include the replacement of fleet vehicles ($6.7 million), installment payments for the California Network System (CALNET) ($2.8 million), the replacement of microwave equipment ($2.1 million), expanded CALNET capacity ($700,000), and expenses associated with the new State Archives Building Parking Facility ($697,000). We discuss several of these proposals in greater detail below.

Property Management Services. Proposed budget-year expenditures for property management services are $230 million, which is $38 million, or 14 percent, less than current-year levels. The decrease is mainly due to one-time expenditures of $45 million in the current year for the local public buildings' portion of the 1990 earthquake safety bond funds. Other major changes include (1) an increase of $8.8 million for debt service payments and operation and maintenance expenses for the new Department of Justice building in Sacramento, (2) a reduction of $1.5 million in operating costs from closing the San Francisco Annex Building, which is to be replaced with a new state building, and (3) a reduction of $2.3 million (48 personnel-years) in the Office of Public School Construction (formerly the Office of Local Assistance) due to a lack of bond funds for K-12 school facilities programs.

DEPARTMENTAL PERFORMANCE

Background

The DGS was established to provide centralized support services to other state agencies. Figure 15 (see next page) summarizes the department's service responsibilities.

For many years, the DGS has come under criticism from client agencies, vendors bidding on state contracts, and the Legislature. The criticism has tended to fall into three categories:

- ***Cost of Service.*** Client agencies believe many services are overpriced, and vendors complain of the cost of the state's procurement process.
- ***Quality of Service.*** Services provided by the department are not always responsive to the needs of clients.
- ***Customer Orientation.*** Because the DGS has a monopoly on many services, clients sometimes feel more like captives than customers.

In our *Analysis of the 1993-94 Budget Bill*, we focused on the issue of the department's performance of its responsibilities, and concluded that performance was seriously inadequate in many areas. We recommended a fundamental rethinking of how the department provides support services to other state agencies, including an end to monopolies and the introduction of competition to determine who should provide services to state agencies. Since that analysis, the department has agreed, in both documents and testimony at various legislative hearings, that there is a need for fundamental change. In that regard, the department has pointed to its participation in the Governor's performance budgeting pilot program as both an indication of its commitment to improve its effectiveness and at the same time a means to do so.

Figure 15

Department of General Services
Centralized Services Provided to State Agencies

Service Area	Services Provided
Statewide Support Services	
Procurement	Central purchasing and materials management
Small and Minority Business	Activities to increase participation of targeted business enterprises in state contracts
Telecommunications	Management and operation of state's telephone system and microwave network
California State Police[a]	Protection of designated office holders; police/security for state property
Interagency Support	Printing, fleet administration, administrative hearings, mail, other business-related functions, and support to the State Allocation Board, which distributes school facilities funds
Management Services	Personnel, accounting, budgeting, records management, insurance, and other management-related functions
Property Management Services	
Real Estate and Buildings	Real estate acquisition and sale, property and construction management, office and parking facility development, energy project development, custodial, and grounds services
State Architect	Architectural/engineering consulting, project management and inspection, plan checking, and mitigation of hazardous conditions

[a] The Governor's Budget proposes transferring the State Police to the California Highway Patrol, effective July 1, 1995.

Will Performance Budgeting Result in Fundamental Changes?

In October 1993 we issued a policy brief entitled *Performance Budgeting: Reshaping the State's Budget Process*. In that brief we noted that implementing performance budgeting was complex, and that an adequate test of performance budgeting will require several years. Consequently, major changes with commensurate results should not be anticipated in the short-term.

The DGS has developed a strategic plan and an initial set of performance measures which are currently being revised in response to a critique by the Department of Finance. The efforts to develop a plan and performance measures have required a significant investment of staff time in the DGS, as well as expenses for consultants to assist with the creation of a strategic plan and provide training. Figure 16 reflects an estimate of the department's investment in performance budgeting. Because it is not possible to account for *all* staff time associated with the implementation of performance budgeting, the estimate should be viewed as a rough approximation.

Figure 16

Department of General Services Cost of Performance Budgeting 1994-95 and 1995-96

	1994-95	1995-96
Strategic planning	$110,000	—
Training	—	$55,000
Project staff	120,000	150,000
Miscellaneous support	200,000	200,000
Other staff	200,000	200,000
Totals	**$630,000**	**$605,000**

As noted above, the department has indicated that performance budgeting is a means to facilitate the fundamental rethinking that all interested parties, including the department, believe is necessary to make the DGS a more effective and responsive provider of services. Although the DGS was designated a performance budgeting pilot department in 1993-94, the pilot project has not progressed as quickly as the administration had planned. Consequently, it is going to take longer—perhaps two or more years—to determine whether performance budgeting will have resulted in fundamental changes and significant improvements in the DGS. (We discuss the state's performance budgeting pilot project in the Crosscutting Issues section of this chapter.)

Some Changes Can Be Made Now. While it may be premature to expect significant changes as the result of *performance budgeting*, it is not too soon to expect the department to begin making significant changes to improve its effectiveness *regardless* of performance budgeting. Some of DGS' operations appear better able to make change and adapt a new approach than others. In the following discussion, we focus on two important operations within the DGS, the Telecommunications Division and the Office of Fleet Administration, and contrast their approaches to change.

CALNET

In 1989 the DGS contracted with a vendor to establish a voice and data system for state government. Known as the California Network System (CALNET), the project was to provide the state its own telephone system plus the ability to provide networking and data transmission services for the state's various information technology programs. According to the contract, the vendor was to have the system in full operation by 1992, at a cost to the state of $67 million.

Because the vendor has not been able to complete a key task—the delivery of a Network Management System as specified in the contract—project completion has been delayed; however, CALNET is operating at reduced level of capability. At the same time, CALNET is not breaking even, with the gap between the DGS' expenses for CALNET and revenue derived from customer departments about $2 million in 1993-94 (we discuss this situation later in this analysis).

Private sector vendors of telecommunications services maintain that CALNET as currently designed will *never* be competitive with, or as capable as, their systems, and some state agencies have in fact selected alternative solutions. For example, the Department of Justice purchased telecommunication services from a private vendor. This use of other systems has presented a difficult situation to the Telecommunications Division, given the department's promise to become more customer-oriented and rid itself of services that can be provided more effectively and/or at less cost by others. The Telecommunications Division is seeking the assistance of an outside consultant to help it determine a course of action which will be most beneficial to the department's customers. Although we have some concerns with the proposed consultant contract, which we discuss later in this analysis, we believe that the Telecommunications Division is moving in a customer-oriented direction.

Office of Fleet Administration

In contrast to the Telecommunications Division, which has taken the initiative to address the problems with CALNET, our review of the Office of Fleet Administration (OFA) indicates almost the opposite. In approving the 1994-95 Budget Act, the Legislature adopted supplemental report language requiring the DGS to investigate possible methods to improve the cost-effectiveness of its vehicle fleet, used by many state agencies in the conduct of their business, and to report its findings and recommendations by December 30, 1994. The supplemental report language required that the department's report specifically address, but not be limited to:

- Methods for expanding competition by allowing the consideration of additional vehicle manufacturers.
- Consideration of the quality of a manufacturers' vehicles in evaluating bids.
- The acquisition of subcompact vehicles.

We have reviewed the department's report and conclude that it does not meet the spirit of the Legislature's request. First, the report states that legislation may be necessary to expand bidding opportunities, but makes no recommendations in this regard. Second, the OFA believes that it would be difficult to devise a method for considering the quality of manufacturers' vehicles when letting state bids but offers no solutions to this. Third, although the OFA reports that it will purchase 60 subcompact vehicles to test their suitability, the report's narrative suggests a predetermination that the test will prove negative. Finally, while the report was to have addressed opportunities for improving fleet operations by addressing the three above-mentioned areas *at a minimum*, the report is limited to *just* those three areas.

IMPROVING FLEET OPERATIONS

Changes Needed in Fleet Operations

We withhold recommendation on $6.7 million proposed in the budget for the replacement of fleet vehicles pending the department's comments, at budget hearings, as to (1) a plan for instituting a reservation system for all fleet rentals, (2) an estimate of savings that can be obtained by centralizing all state fleet operations, and (3) a plan to put all or a portion of the state's fleet operations out to competitive bid.

The budget requests $6.7 million to replace aging and damaged vehicles in the state's fleet. This is roughly equivalent to the amount spent for replacement of vehicles in the current year.

Most Employees Stand in Line and Wait. Most state employees who need to check out a state car from the DGS in order to travel in the conduct of their business are not allowed to reserve sedans in advance (only trucks and vans may be reserved in advance). As a consequence, many state employees spend unproductive time waiting for a vehicle to be turned in so that it can be checked out to another employee. If an insufficient number of vehicles are turned in, the employees are faced with the option of canceling the trip, trying to get one from a private rental agency (the OFA will assist in this regard), or using their own vehicle.

This situation could be resolved with a computer-based reservation system similar to those used by private sector rental agencies. The department's customers would certainly view this as a strong indication of a customer-orientation, and a reservation system may save the OFA money in the long-run.

Is Centralization the Answer? The OFA's report to the Legislature on how to improve fleet operations states that past analyses of the state's fleet operations, and experience in other states, indicate that significant savings can be realized with a centralized, rather than decentralized fleet. However, the report does not make any recommendations to pursue this concept. With a total state vehicle fleet of 12,000 passenger vehicles, of which the OFA manages only 5,000 (the remainder are spread across many agencies), the department may be missing an opportunity by not studying the potential of a centralized fleet.

Will Competition Improve Fleet Operations? We believe that one reason the OFA may be slow to innovate is because it has been able to maintain a sizable fleet without real competition. When we asked the OFA about this, we were advised that the OFA periodically reviews rates charged and services provided by private rental companies, and has determined that its fleet operation has always been the most cost-effective, with better rates than could be obtained from the private sector. The OFA may be correct based on *its surveys,* but no survey can compare to an *open competition* by vendors in the market place to provide this service.

For the reasons discussed above, we withhold recommendation on $6.7 million requested to replace fleet vehicles and recommend that the department be prepared to comment, at budget hearings, as to (1) a plan to institute a reservation system for all fleet rentals, (2) an estimate of savings that can be obtained through centralization of the state's passenger vehicle fleet, and (3) a plan to conduct an open competition for all or a portion of the state's fleet operations.

Substantial Cost to Convert To Alternative Fuel Vehicles

The conversion of the state's vehicle fleet to alternative fuel vehicles will substantially increase the cost of vehicle replacement, at current prices.

Included in the proposed $6.7 million to replace aging and damaged vehicles is $2.5 million to acquire alternative fuel vehicles. The department proposes to acquire these vehicles in accordance with an Executive Order of the Governor (W-100-94) which requires the purchase of alternative fuel vehicles, *if funds are appropriated*, according to the schedule shown in Figure 17. The Governor's order is consistent with the National Energy Policy Act of 1992, which promotes the use of alternative fuel vehicles to reduce emissions.

Figure 17

Department of General Services Minimum Goals for Alternative-Fueled Vehicles

	Percent of Fleet
1996	25%
1997	33
1998	50
1999	75

According to the department, each vehicle costs on the average approximately $4,500 more than a comparable traditionally fueled vehicle (up to $15,000 more for an electric vehicle). In the case of sedans, this cost difference equates to a *45 percent increase* in the cost of purchasing the vehicle. Should this policy be extended to the total state vehicle fleet (about 12,000 vehicles), the potential *added cost* to replace them with alternative fuel vehicles amounts to $40.5 million through 1999.

TELECOMMUNICATIONS

CALNET: Part of a Statewide Problem, or Part of a Statewide Solution?

Despite an investment of approximately $20 million to date, with additional expenditures through 2001-02 estimated at $50 million, CALNET continues to lose money while some state agencies buy telecommunication services from the private sector.

In a report on statewide information technology issued by our office in June 1994, we noted how the number of separately maintained data communication networks had grown substantially in the absence of effective coordination and the lack of a statewide plan. CALNET, conceived as an effective answer to both the state's telephone and data transmission needs, has instead become a costly endeavor which has not yet reached the operational capability originally intended.

It is important to note, however, that CALNET is providing both voice and data communication support to many state agencies. It is simply not recovering its cost of providing those services at current rates, and as noted above, the difference between cost and revenue was about $2 million in 1993-94.

Telecommunications Division staff maintain that CALNET could break-even at even lower rates if state agencies were required to use CALNET in lieu of purchasing telecommunications support from other sources. However, the department has not exercised its authority to force all departments to use CALNET, and is understandably reluctant to raise rates because doing so would make CALNET less competitive with private sector services. In addition to wanting to be more customer-oriented, and therefore not force business, there may be sound technical or service reasons for allowing some customers to shop around for telecommunications services. Nevertheless, the end result is the same: CALNET continues to lose money. At the same time, the proposed budget includes $3.5 million to (1) meet the next installment payment on the vendor contract—$2.8 million, and (2) add capacity to CALNET—$697,000. As we indicated in our June 1994 report on statewide information technology, it makes no sense to invest heavily in a system with statewide capability and continue to invest in many separate systems at the same time.

Will a Consultant Study Improve Matters?

The department's intention to hire a consultant to study the state's telecommunications needs and recommend a strategic direction is an important step in the right direction. The effectiveness of the consultant's effort, however, will be dependent on the department's ability to develop a contract which will allow an unbiased assessment of potential solutions.

On December 19, 1994, the department, through its Telecommunications Division, released a Request for Conceptual Proposal (RFCP) to begin the process of hiring a consultant to evaluate the existing strategic direction for state telecommunications and make recommendations to improve the effectiveness and efficiency of state telecommunications policies and practices. According to the RFCP, the consultant's study should include a review of the competitiveness of CALNET. The department plans to award the contract in March 1995, with a final report due in August 1995. We believe that this is a step in the right direction, and we believe that certain aspects of the RFCP represent an improvement in contracting practice (for example, weighing the evaluation 30 percent for price, and 70 percent for other factors, such as vendor and staff qualifications, understanding the business problem, and the approach to problem resolution).

Much at Stake for the Telecommunications Division. The department, through its Telecommunications Division, has invested a considerable amount of resources to plan and implement CALNET, and there is a strong desire to make CALNET work. Moreover, the Telecommunication Division views CALNET as the centerpiece of a reengineered state telecommunications system. The desire to see CALNET succeed could influence both the contract award and the tasks the winning consultant is asked to accomplish. This influence could occur, for example, in the way the department handles questions from potential bidders as to what is meant by certain RFCP requirements.

Our review of the RFCP leads us to conclude that there are aspects of the RFCP that should be clarified in order to ensure the best possible product from the consultant who is selected. For example, the RFCP includes suggested approaches to the consultant study, but also indicates that *all* of the suggested approaches must be used. Certain of these approaches are not clear as to their purpose, and could result in needless costs.

Therefore, while we support the department's plan to hire a consultant to study the telecommunication situation, we believe that the consultant's effectiveness will depend upon the department's ability to eliminate any predisposition to favor CALNET and develop a contract allowing for the unbiased assessment of potential solutions to the state's telecommunications needs.

Cost of Converting Public Safety Microwave Network to Digital Technology

We recommend that the department adopt a plan to convert the Public Safety Microwave Network (PSMN) to digital technology.

Conversion Required to Meet Customer Needs. The PSMN is a statewide microwave system operated by the DGS since 1978 to meet the communications needs of all public safety agencies within the state. Because network technology is becoming increasingly reliant on digital systems, the DGS has been converting to digital in order to meet the needs of clients who are adopting the newer technology (for example, the California Highway Patrol). The department is trying to avoid any need for a rate increase to customer agencies by converting to digital equipment when the older analog equipment is in need of replacement, thereby accomplishing a gradual conversion within the annual maintenance budget. In that regard, the proposed budget includes $2 million to replace old analog equipment with digital technology.

Need for a Conversion Plan. While the department's approach has seemed to work so far, we are concerned that it may not work as well in the near future. We base our concern on an August 8, 1994 study commissioned by the department entitled *Public Safety Microwave Network Analog to Digital Conversion Plan*. The study identifies three options for converting the PSMN to digital, each costing $90 million. The option recommended by the report is to upgrade the entire system to digital; this option is estimated to require five to ten years to accomplish. The study notes that the current funding level for conversion to digital "creates a major problem" in that the DGS is prevented from moving as rapidly as it should to meet its client agencies' changing requirements. The study further notes that failure to use a fully integrated and technologically matched system will cause significant problems since the PSMN is not able to operate effectively with the capabilities installed by its client agencies.

According to the department, it has not adopted the consultant's specific recommendation to convert the entire system to digital technology, although it seems to be moving slowly in that direction. Given the importance of the PSMN, we believe that the department should have a specific plan which addresses the changing needs of its clients *and* the funding issue raised in the study. Consequently, we recommend that the Legislature adopt the following supplemental report language:

The Department of General Services shall adopt a plan for the conversion of the Public Safety Microwave Network to digital technology and provide a copy of that plan to the Legislature by January 2, 1996. The plan shall address the changing needs of the department's customers and how the department proposes to fund implementation of this plan.

TECHNOLOGY INITIATIVES

The department continues its efforts to employ various technology initiatives to better serve state and local government technology needs; however, certain of these initiatives may be working at cross-purposes and it is not clear as to whether the others are, or can be, as successful as anticipated. In this section we focus on five current initiatives:

- State computer store.
- Multiple award schedules.
- Videoconferencing.
- Electronic commerce.
- Reducing paper by eliminating hard copy.

Are Two DGS Services Complementary or Competing With Each Other?

We recommend that the department advise the Legislature, at budget hearings, on the extent to which its state computer store and its multiple awards schedule program are intended to be complementary or in competition with each other.

State Computer Store Sales Continue to Increase. Since 1986-87 the department has contracted, via competitive bidding, with the private sector for the operation of a state computer store selling desktop computer systems and related services to state agencies. Sales from the state store totaled approximately $305 million as of December 31, 1994, and are, according to the department, growing at an annual rate of about 25 percent. At present, there is only one store, located in Sacramento, and by DGS policy only Sacramento-area state agencies are allowed to purchase from the store. The department advises, however, that it plans to award a new contract in April 1995 which will provide for additional stores in San Francisco and Los Angeles, and that these new stores and the Sacramento store will be open to purchase from other governmental agencies.

California Multiple Awards Schedule (CMAS) Sales Also Increasing. In May 1994 the department implemented a new program to make it easier for state agencies to acquire information technology products and services. The concept is modeled after a long-standing program in the federal government which allows federal agencies to buy commodities and services from vendors based on price schedules, thereby avoiding the time and expense associated with conducting a competitive bid each time they want to make an acquisition. The state's version is known as the CMAS. Unlike the state computer store, the CMAS has always been available statewide, as well as to other governmental entities. Since its inception in 1994, CMAS sales are estimated by the department to be $16.7 million as of January 1995, and growing at an increasing rate as more vendors are added. Some of the same products are available through both CMAS and the state computer store; however, the prices can vary.

Each Program Managed Separately. It appears that both programs operated by the DGS are successful in terms of continually increasing sales, but each program is managed separately within the department, and there is a certain level of duplication in terms of products offered, which are sometimes priced differently. While there has for some time been an interest outside the DGS to expand the state computer store statewide and make it available to other governmental agencies, the department resisted expansion for several years, yet established the CMAS as a statewide program available to other governments.

Although, as noted above, the department indicates that the state computer store will expand and be open to other governments, it is not clear, given the different approaches and duplication of products, whether the department views these two programs as complementary or in competition with each other. We believe that this is an important question which the department should address during budget hearings, because state agencies and other governmental entities are becoming increasingly dependent on *both* programs to meet their information technology needs.

Videoconferencing—What Is it Saving?

While departments continue to invest in videoconferencing to operate more effectively, it is not clear as to whether state agencies are taking maximum advantage of this technology or whether its use is as effective as anticipated.

Videoconferencing is a relatively new technology which enables people in different geographic locations to conduct a face-to-face meeting without having to all locate in one place. Instead, participants travel to the videoconferencing site nearest to them. Thus, individuals in downtown Los Angeles can make a local trip to a videoconferencing site in order to "meet" with individuals who may assemble at a site in Sacramento. With the use of computers, television cameras, television monitors, and communications networks, all are able to see each other and converse, as well as display information from computers or overhead projectors. Additionally, hard copies of charts created during the meeting can be sent by facsimile transmission (FAX). The presumed benefit of videoconferencing is that it may significantly reduce the cost of travel, including flights, lodging, and meals, as well as nonproductive travel time by employees. According to the DGS, a one-hour meeting involving three people from Sacramento and three from Los Angeles would save a net $270 and 21 hours of staff time if conducted via videoconferencing.

To facilitate state agency use of videoconferencing, the DGS operates three videoconferencing facilities (Sacramento, San Francisco, Los Angeles) and has established a master contract from which agencies may acquire videoconferencing equipment. Moreover, the administration has authorized state departments to redirect up to 25 percent of their travel budgets to acquire videoconferencing equipment. As a consequence, as of late January 1995, 14 agencies had installed over 50 systems, amounting to approximately $4 million in sales under the master contract. The DGS has established a Videoconferencing Advisory Committee to guide the state's implementation of videoconferencing; however, the extent to which the growing investment in videoconferencing is producing offsetting savings is not known, because departments are not required to report this information. Without this information, it is difficult to encourage additional departments to use videoconferencing, and as a result the state may be missing an opportunity.

Electronic Commerce

Efforts to improve the state's procurement process through the use of information technology (IT) are on hold pending the resolution of responsibility for the state's IT coordination.

Prompted by both the Legislature in enacting Ch 1775/93 (AB 565, Polanco), and the administration's own desire to improve the state's procurement process, the DGS conducted a pilot project to determine whether computer-based procurements could eliminate paper transactions, reduce errors, shorten the procurement cycle, and produce net savings. This alternative process is known as "electronic commerce," because orders, invoices and payments, and related matters, such as inventory accounting, are accomplished electronically using computers and communication networks. The department had been eager to conduct the pilot test, believing that substantial savings could be realized from reducing the need for clerical staff and reducing errors.

In an October 14, 1994 report on the pilot project required by Chapter 1775, the DGS indicates that electronic commerce "is worth doing and the state should strive for full implementation." However, the report also cites several obstacles currently in the way of full implementation, including the state's IT coordination situation (please see the State Administration section of this *Analysis*). Consequently, the report recommends a more deliberative approach to implementing electronic commerce, placing primary responsibility for guidance with the new IT oversight organization the Governor has indicated he plans to establish. Consequently, until a new structure is defined, it appears that significant forward progress on implementing electronic commerce will not be made.

Putting SAM On-Line

The department is moving in the right direction in attempting to obtain added value from the state's growing and substantial investment in computers by making the State Administrative Manual (SAM) available electronically, which should eventually eliminate costs statewide to maintain and use the bulky paper version.

The SAM contains the various policies, rules, and procedures state agencies must follow in the conduct of their business. The SAM is two volumes, and unless maintained, quickly becomes dated and therefore of questionable utility (there are frequent revisions to the many sections in the manual). The DGS has recently completed an effort to place the SAM on a diskette which can be used on desktop computers which have CD-ROM capability. The intent is to reduce state agencies' reliance on the bulky hard copy.

Given the state's substantial and continually growing investment in computer capability, putting a bulky and frequently changing manual such as the SAM into a computer format appears worthwhile. It is relatively inexpensive to produce a computer diskette and maintain a computer version of the SAM once the process has been established; however, as long as the department maintains a hard copy version, optimum savings will not be realized (the department indicates that it spends about $390,000 annually to maintain the SAM). According to the department, the number of requested hard copy versions dropped from about 6,000 to 2,000 after the DGS imposed a fee for the paper version, but the number of requests for the paper version appears to be increasing.

We believe that the DGS is moving in the right direction—trying to utilize the installed computing capacity in lieu of maintaining a hard copy version—but it is not yet clear as to how soon the CD-ROM version will be usable by a broad cross-section of employees who need access to the SAM. This is because CD-ROM capability is relatively new with respect to state desktop computers.

STATE POLICE

Responsibility for State Police to Be Transferred

The department's proposed budget reflects the transfer of the budget and responsibilities of the California State Police (CSP) to the California Highway Patrol (CHP).

In accordance with the Governor's proposal to transfer the budget and responsibilities of the CSP to the CHP, the department's proposed budget reflects elimination of $28.2 million and 408 personnel-years. The Governor indicates that legislation will be introduced to effect the transfer. Because the transfer would also eliminate the need for related departmental overhead, an additional $312,000 and 5.6 personnel-years have been eliminated from the DGS' budget. However, the transfer will result in the DGS having to purchase approximately $2.4 million worth of police services from the CHP. Consequently, the *net effect* of the transfer will be the elimination of $26.1 million and 413.3 personnel-years from the department's budget. We discuss the proposed transfer in more detail in our analysis of the CHP (please see the Transportation section of this *Analysis*).

PUBLIC EMPLOYEES' RETIREMENT SYSTEM (1900)

The Public Employees' Retirement System (PERS) administers retirement and related benefit programs that serve approximately 700,000 active and 300,000 retired employees. The participants in these programs include state employees, most nonteaching school employees, and employees of the 1,280 public agencies within California that contract for retirement benefits available through the system. The proportion of members is approximately one-third each for state employees, nonteaching school employees, and employees of other local agencies.

The system administers a number of alternative retirement plans through which the state and contracting agencies provide their employees with a variety of benefits. The costs of these benefits are paid from employer and employee contributions equal to specified percentages of each participating employee's salary. These contributions are designed to finance the long-term, actuarial cost of the various benefits.

In addition to its retirement programs, the PERS health benefits program offers state and other public employees (in over 800 contracting agencies) a number of basic and major medical plans, on a premium basis.

State Contributions and Transfers to PERS

Background. Each year the state allocates funds for the purpose of prefunding retirement benefits earned by employees for their current service to the state. The necessary funds are included in the budget of each department based on expected salary and wage expenditures for that year and contribution rates specified in Control Section 3.60 of the annual Budget Act. The budget includes $980 million from all funds ($490 million General Fund) for that purpose in 1995-96. With each pay period, these funds are accumulated by the State Controller. (For the General Fund this "accumulation" occurs only in a recordkeeping sense.) For salaries and wages paid from funds other than the General Fund, the Controller transfers the accumulated contributions on a quarterly basis to the PERS trust fund.

General Fund Transfers Are Deferred. Chapter 71, Statutes of 1993 (SB 240, Committee on Budget and Fiscal Review), amended Government Code Section 20751 to provide for General Fund contributions to be transferred to the PERS on July 1 of each year, 12 months in arrears of the end of the annual payroll reporting period.

As a result, annual transfers *effectively* are two fiscal years in arrears. Thus, the General Fund transfer to the PERS in 1995-96 ($444 million) is based on contribution rates and salaries paid in 1993-94 minus available credits to the state's accounts. The General Fund cost (totaling $490 million) based on 1995-96 salaries will not be paid to the PERS until 1997-98. This deferred amount is not set aside into an account to collect interest. Instead, it is effectively reverted to the General Fund and is counted as part of the General Fund balance available for general state expenditures in 1995-96.

General Fund Deferrals May be Invalidated by Courts. In a recent decision, the Superior Court in Sacramento County has ordered the state to resume General Fund transfers to the PERS on a current, rather than deferred, basis. The court ruled that the PERS statutes contain an implied contractual obligation for the state to make transfers to the retirement system on a current basis. The budget, however, continues to schedule transfers on a deferred basis on the assumption the state will prevail in the appellate courts. The central issue from the state's perspective is to maintain the Legislature's constitutional authority to decide the timing and amounts of General Fund appropriations for the state's contributions to the PERS. If the state loses the appeal, and is required to immediately pay the deferred amount, the one-time General Fund impact would be $955 million. In order to keep the budget in balance, the state would have to reduce other expenditures and/or increase revenues accordingly.

Overview of the PERS Administrative Budget

The Budget Bill includes only informational items of proposed PERS expenditures (other than one item of appropriation for health benefits administration) because the PERS has authority under Proposition 162 to spend funds without appropriations by the Legislature.

Administrative Expenditures. For informational purposes, the budget shows expenditures totaling $162 million for administration of the PERS in 1995-96. Of the amount in the Governor's budget, only $7.7 million for health benefits administration is proposed for appropriation in the Budget Bill (Item 1900-001-950). Most of the remaining amounts appear in the Budget Bill, but as informational items rather than items of appropriation. This is because a provision of the California Pension Protection Act of 1992 (Proposition 162) grants "plenary" authority to public retirement boards within the state for administration of retirement systems.

Figure 18 displays projected 1995-96 expenditures and staffing levels for PERS administration. The $162 million shown for 1995-96 is $2.3 million, or 1.4 percent, less than estimated current-year expenditures. It should be noted, however, that the 1995-96 proposal at this point is only a "baseline" budget and does not represent the PERS' expenditure plans for 1995-96. This is because the PERS board has not approved a 1995-96 budget and does not plan to consider one until May. Therefore, comparison at this time of current-year and proposed budget-year expenditures is premature.

Figure 18

Public Employees' Retirement System Administrative Expenditures and Staffing Levels 1995-96

(Dollars in Thousands)

Program	1995-96 Baseline[a]
Operations	$84,651
Investment advisors	76,939
Expenditure Totals	**$161,590**
Staffing level (personnel-years)	965

[a] Does not include amounts for new initiatives or program augmentations because the PERS board will not consider a 1995-96 budget until May.

Reviewing the PERS' expenditures over fiscal years 1992-93 to 1993-94, however, reveals a rapid increase in expenditures after the passage of Proposition 162 in November 1992. As shown in Figure 19,

Figure 19

Public Employees' Retirement System Administrative Expenditures and Staffing Levels 1992-93 to 1994-95

(Dollars in Thousands)

Program	1992-93 Actual	1993-94 Actual	1994-95 Estimated	Change from 1992-93
Operations	$58,957	$73,445	$86,927	47.4%
Investment advisors	65,163	76,622	76,939	18.1
Expenditure Totals	**$124,120**	**$150,067**	**$163,866**	**32.0%**
Staffing level (personnel-years)	810	870	989	22.1%

in the course of two fiscal years PERS' administrative spending has increased by almost $40 million, or *32 percent*. The size of PERS' staff has increased by 179 personnel-years, or 22 percent.

Overview of PERS Investment Performance

We recommend that the PERS report to the fiscal committees prior to budget hearings on recent poor investment performance by the PERS trust fund. We further recommend that the PERS report on the reasons for a recent change in investment strategy and the potential under that strategy for increased fund volatility.

The Board of Administration of the PERS manages, in trust for the system's members and participating employers, an investment portfolio valued at approximately $78.5 billion (as of September 30, 1994). Earnings from the trust fund, added to ongoing contributions from employers and employee members, are intended to assure that all future payments to retired members will be met. In projecting the adequacy of the system to meet future payments, the board assumes that its investments will yield an average annual rate of return of 8.75 percent. To the extent investments out-perform this "actuarial" interest rate over time—and other major factors are held constant—annual contributions from the state and other participating employers are reduced. To the extent investments under-perform this target employer contributions must be increased to maintain the actuarial soundness of the trust fund.

Market Value of Fund Has Declined in Last Year*.* At the time this *Analysis* was prepared, the most recent investment data available from the PERS was for the quarter ending September 30, 1994. For the one-year period October 1, 1993 to September 30, 1994, the PERS trust fund earned only 0.7 percent. Although the rate of return was slightly positive, the market value of the fund *declined by $700 million* because outlays from the fund for pension payments and for administration exceeded the sum of investment earnings plus employer and employee contributions. Looked at from a longer perspective, however, fund performance has more closely approximated the assumed target rate. Over the last three years, for example, the average annual rate of return was 8.5 percent.

While review of pension fund performance calls for long-term perspective, the poor performance of the last year merits legislative attention, given (1) the great sums of public monies (past, present, and future) committed to the fund, and (2) the possibility that recent fund performance could presage continuing poor results. In view of the above we recommend that, prior to budget hearings, the PERS report to the fiscal committees on investment performance. At a minimum, this report should include:

- A discussion of the causes of recent poor performance.
- Near-, mid- and long-range prospects for each asset class (such as real estate, bonds, etc.).
- Specific implications of recent poor performance on the contribution rates payable by the state and other employers (and the impact on rates if such performance were to continue).
- Steps to be taken by the board to assure meeting the actuarial interest rate of 8.75 percent.

The PERS also should report on the board's December 1994 decision to alter its asset allocation strategy (including an increase in the share of the fund invested in foreign and domestic equity from 49 percent to 63 percent). Specifically, the PERS should comment on the reasons for the changed strategy and the potential for increased volatility of returns under the strategy.

STATE TEACHERS' RETIREMENT SYSTEM (1920)

The State Teachers' Retirement System (STRS) was established in 1913 as a statewide system for providing retirement benefits to public school teachers. Currently, the STRS serves about 320,000 active and 140,000 retired teachers and community college instructors (and survivors). Retirement and ancillary benefits totaling $3 billion are expected to be paid from the Teachers' Retirement Fund (TRF) in 1995-96.

Overview of the 1995-96 Budget. The budget includes $36.7 million from the TRF for support of the STRS operations in 1995-96. This is an increase of $1.6 million (4.5 percent) from estimated current-year expenditures. In addition, under a continuous appropriation authority, the STRS is projected to spend $52.6 million for outside investment advisors. This equals estimated current-year expenditures for this purpose, but is almost $20 million (*64 percent*) more than actual expenditures in 1993-94.

Figure 20 summarizes actual, estimated, and proposed administrative spending by the STRS for the three fiscal years starting in 1993-94. Total STRS administrative expenditures, consisting of state operations and investment advisors, are proposed to be $89.3 million in 1995-96. This represents an increase of less than $2 million (1.8 percent) above estimated current-year expenditures and an increase of $26 million (*41 percent*) over actual expenditures in 1993-94.

Figure 20

State Teachers' Retirement System
Administrative Expenditures
1993-94 Through 1995-96

(In Thousands)

Program	1993-94 Actual	1994-95 Estimated	1995-96 Proposed
Operations	$31,070	$35,170	$36,742
Investment advisors	32,073	52,600	52,600
Totals	**$63,143**	**$87,770**	**$89,342**

Proposition 162 and the STRS Budget Request. Passage of the California Pension Protection Act of 1992 (Proposition 162) at the November 1992 election grants to public retirement boards in the state "plenary" authority for administration of retirement systems. Unlike the Public Employees' Retirement System, the STRS at this point has not asserted that this new constitutional authority removes STRS administrative spending from legislative review and approval through the budget process.

State Contributions to Teachers' Retirement Fund

State General fund contributions to the State Teachers' Retirement System total nearly $900 million in the budget year—an increase of almost $34 million.

The STRS receives contributions from teachers and their employers totaling 16 percent of active teachers' payrolls. These contributions are not sufficient to provide for the cost of teachers' basic retirement benefits (the so-called "normal" cost of the system, which is 17.17 percent of payroll), nor the protection of retirees' purchasing power (a nonvested benefit). In addition, the STRS has an unfunded liability of *$8.4 billion* that is amortized over the next 26 years (based on the most recent actuarial valuation as of June 30, 1993). All of these shortfalls are addressed through annual transfers from the General Fund.

In total, the budget shows General Fund transfers of $899 million to the TRF in 1995-96. These transfers are for three purposes:

- The STRS normal cost deficit and unfunded liability, as required by the Elder Full Funding Act ($530 million).
- Maintenance of retirees' purchasing power at 68.2 percent of original allowances ($315 million).
- Reimbursement for retirement benefit enhancements (an adjustment for inflation and an increase in minimum retirement allowances) mandated by the state in 1979 and 1980, respectively ($54 million).

Figure 21 summarizes actual, estimated, and budgeted transfers for 1993-94 through 1995-96. The mandated cost reimbursements are included in Item 6100 of the Budget Bill (Department of Education) and are counted toward the state's Proposition 98 funding guarantee for K-14 schools. The other two categories of General Fund spending, $845 million in the budget year, are automatically transferred under current law and are in addition to the amounts provided to K-14 schools under Proposition 98.

Figure 21

State Teachers' Retirement System General Fund Contributions to Teachers' Retirement Fund 1993-94 Through 1995-96

(In Millions)

Program	1993-94 Actual	1994-95 Estimated	1995-96 Budgeted
Elder Full Funding Act	$517.9	$517.9	$529.6
Purchasing power protection	239.9	306.3	315.4
Mandates	57.6	40.9	53.9
Totals	**$815.4**	**$865.1**	**$898.9**

Overview of STRS Investment Performance

We recommend that the STRS report to the fiscal committees prior to budget hearings on recent poor investment performance by the STRS trust fund and prospects for the future.

The Teacher's Retirement Board manages in trust—for the STRS's members, K-14 school districts, and the state—an investment portfolio valued at $48.5 billion (as of September 30, 1994). Earnings from the trust fund, added to ongoing contributions from the state, school districts, and employee members, are intended to assure that all future payments to retired members will be met. In projecting the adequacy of the system to meet future payments, the board assumes that its investments will yield an average annual rate of return of 8.5 percent. To the extent investments out-perform this "actuarial" interest rate over time—and other major factors are held constant—the unfunded liability of the system (currently $8.4 billion) declines. Since current law requires the state to liquidate the unfunded liability on an amortized basis, a decline in the unfunded liability shortens the time period over which the state must make these amortization payments. (The state will make estimated payments of $350 million for this purpose from the General Fund in 1995-96. These payments, which increase each year, are expected to continue for the next 26 years, based on current projections of the unfunded liability.) To the extent investments under-perform the actuarial interest rate the unfunded liability increases, as does the number of years of required state payments.

Market Value of Fund Has Declined in Last Year. At the time this *Analysis* was prepared, the most recent investment data available from the STRS was for the quarter ending September 30, 1994. For the one-year period October 1, 1993 to September 30, 1994, the STRS trust fund earned a *negative* 1.2 percent. This resulted in a $238 million decline in the value of the fund. Looked at from a longer perspective, however, fund performance has more closely approximated the actuarial rate. Over the last three years, for example, the average annual rate of return was 7.9 percent. Over the last five years it was 8.65 percent.

While review of pension fund performance calls for long-term perspective, the poor performance of the last year merits legislative attention, given (1) the great sums of public monies (past, present, and future) committed to the fund, and (2) the possibility that recent fund performance could presage continuing poor results. In view of the above, we recommend that the STRS report to the fiscal committees prior to budget hearings on investment performance. At a minimum, this report should include:

- A discussion of the causes of recent poor performance.
- Near-, mid-, and long-range prospects for each asset class (such as real estate, bonds, etc.).
- Specific implications of recent poor performance on the unfunded liability and the amortization period for state payments (and the impact on rates if such performances were to continue).
- Steps to be taken by the board to assure meeting the actuarial interest rate of 8.5 percent.

STEPHEN P. TEALE DATA CENTER (2780)

The Stephen P. Teale Data Center (TDC) is one of the state's two general purpose data centers (the other is the Health and Welfare Agency Data Center). It provides a variety of information technology services to over 200 state agencies. The cost of the center's operation is reimbursed by these client agencies.

The budget proposes $78.2 million from the TDC Revolving Fund for support of the center's operations in 1995-96. This is an increase of $1 million, or 1.3 percent, over estimated current-year expenditures.

Costly Mainframes Continue to Dominate

We recommend that the Legislature adopt supplemental report language requiring the data center to adopt and submit a plan to reduce customer dependence on costly mainframe solutions and increase the use of less costly "open" systems.

In the current year, both the Health and Welfare Agency Data Center (HWDC) and the TDC, the state's largest general purpose data centers, received approval from the Department of Finance (DOF) to acquire additional and very expensive "mainframe" computer capacity. This capacity will be acquired to meet a variety of needs, including increased demand for mainframe services and improved system operation. Both data centers plan to acquire similar computers—two at the HWDC at a total estimated cost of $29.3 million, and one at the TDC at an estimated cost of $13 million.

Given workload demands, we have no basis for recommending against this increase in mainframe capacity. However, we note that the cost of these computers is substantially higher than the cost of alternative hardware. For example, networked personal computers and other computers designed to operate with what are referred to as "open" systems, such as the UNIX operating system, are much less costly. ("Open" systems can run on a wide variety of hardware platforms and are therefore more "open" than proprietary software which may run on only one brand of computer.) Although both data centers offer such open system support, neither has a comprehensive plan to assist customers to reduce their dependence on mainframes. Moreover, the current level of investment in each data center for low-cost alternatives is relatively small in comparison to the growing investment in mainframe support.

Cost Differential Is Substantial. Although there are many factors which need to be considered in determining which technological approach is the most appropriate and cost-effective to meet a specific departmental need, the major differences in hardware costs alone invite further analysis. For example, the type of mainframe computers being acquired by both data centers are several times the cost of a comparable UNIX computer, based on a comparison of processing power. Moreover, there are also very significant differences between the cost of system software, maintenance, and support personnel between the traditional mainframe and the so-called "open" systems.

Trend Is Away From Mainframe Domination. Because of the cost differences, and other reasons relating to customers' computer application requirements, the clear trend in information systems development nationally is away from reliance on traditional mainframes. The role of large mainframes is changing dramatically, and most organizations are trying to find ways to avoid adding to mainframe capacity. Many others have adopted strategies under which new applications are specifically developed to run on computers other than mainframes, while a number of organizations have converted applications from mainframes to less costly solutions.

A Plan Is Needed Now. The data center has the technical expertise and ability to develop a plan to shift its emphasis to alternatives which offer both cost savings and improved service to its clients. Without such changes, the data center may become less relevant as customer departments determine that they can obtain better solutions elsewhere.

For this reason, we recommend that the Legislature adopt supplemental report language directing the TDC to adopt a plan to reduce its customers' dependence on traditional mainframe solutions which are not as beneficial to the customers as other alternatives. We further recommend that this plan be submitted to the Legislature by December 1, 1995.

> The data center shall adopt a plan for reducing customer dependence on traditional mainframe solutions by (1) assisting customers to develop new computer applications, where feasible, on alternative systems, and (2) moving existing applications off of mainframe computers where doing so would reduce customers' costs. The data center shall submit the plan to the Legislature by December 1, 1995.

We have included a similar recommendation in our analysis of the HWDC.

Duplicative Service Should Be Phased Out

We recommend that the Legislature adopt Budget Bill language directing the data center to cooperate with the State Controller to develop a plan to phase out the Human Resources Information System (HRIS) maintained by the data center and move client agencies to the California Leave Accounting System (CLAS) maintained by the Controller.

Investing in a Dying System. Over the past several years the data center has developed and enhanced the Human Resources Information System (HRIS) to provide leave accounting and related services to client departments. At the time the data center was developing its system, the State Controller was planning a *statewide* system known as the California Leave Accounting System (CLAS). Since then, the CLAS has become operational. The number of state employees covered by HRIS is shrinking significantly, at the same time that those covered by the CLAS continue to grow. It is estimated that by the end of 1995, the Controller's system will cover 163,000 employees, while the HRIS will handle 18,000 employees. It appears that a significant portion of the covered employees will be moved to CLAS in the near future.

Although HRIS has some features which CLAS does not, CLAS is priced more attractively than HRIS and provides capability which HRIS cannot match. Despite the trend toward CLAS, the data center invested $500,000 in 1993-94 to make necessary modifications to HRIS. According to information provided by the data center, the cost to support HRIS in 1994-95 will exceed anticipated revenue by a factor of three to one ($627,000 in expenses versus $216,000 in revenue).

Considering these factors, we believe that the state should not continue to invest in improvements to HRIS when CLAS is becoming the statewide system of choice. The data center should freeze HRIS at its current level of customers and capability and work with the Controller to plan for an eventual phase out of HRIS. Accordingly, we recommend that the Legislature adopt the following Budget Bill language:

> The Stephen P. Teale Data Center shall cooperate with the State Controller to develop a plan to phase out the Human Resources Information System (HRIS) maintained by the data center and begin to move client agencies to the California Leave Accounting System maintained by the Controller. The plan shall be provided to the Chairpersons of the fiscal committees and the Joint Legislative Budget Committee by December 1, 1996. It is the intent of the Legislature that the data center shall not add new client departments to its subscribers of HRIS services or invest in enhancements.

Efforts Needed to Reduce Number of Managers

We recommend that the data center advise the Legislature, at budget hearings, regarding its efforts to reduce the number of high-level technical managers to a more appropriate ratio.

Several High-Level Technical Managers Do Not Manage. According to the data center's October 20, 1994 organization chart, the center has 36 relatively high-level managers of its technical operations, ranging from the Data Processing Manager II level to Data Processing Manager III. Of this management pool, six managers, or 17 percent, were in special assignments in which they supervised no staff.

Although state policy provides for special situations wherein a manager can be removed from traditional management responsibilities to serve another purpose, the degree to which the data center places high-level managers into nonmanagement roles appears to be excessive. As a comparison, we reviewed the management assignment practices of the HWDC, and found that the HWDC used special assignment of high-level technical managers very sparingly and infrequently.

The Number of High-Level Technical Managers Has Increased. One reason the data center may place many of its high-level technical managers in special assignments is because the number of such managers has increased disproportionately to the increase in technical staffing, thereby decreasing the need for managers to supervise and manage other staff. For example, the number of high-level technical managers at the TDC has increased approximately *60 percent* since 1989-90, while during the same period the total number of budgeted technical staff increased only about 4 percent. Overall, *total* data center staffing during this period actually *decreased* by approximately 6 percent.

We conclude that the data center needs to establish a more reasonable ratio of managers to technical staff, consistent with the administration's efforts to streamline organizations to increase their efficiency and effectiveness. In this regard, the data center was required by the DOF and the Department of Personnel Administration to develop such a plan; however, the data center's plan, submitted in April 1994, has as yet *not* resulted in any significant change in the current imbalance of the higher level managers. Therefore, we recommend that the data center explain at budget hearings its efforts to reduce managers.

Legislative Direction Has Not Been Followed

We recommend that the Legislature adopt Budget Bill language requiring (1) an independent review of the data center's billing and cost recovery practices and (2) a board of directors to oversee specific activities of the data center.

Background. Last year, we recommended an independent review of the data center's billing and cost recovery practices to ensure that all clients paid fully for the services received. We made this recommendation because the data center had made special arrangements with some clients where services were provided at significantly below cost—or not billed at all—which resulted in all other clients, in effect, making up the loss through the fees they paid the data center.

In addition, we also recommended the creation of a board of directors to oversee certain activities of the data center, primarily the review of the annual budget, proposed rate changes, and other proposed actions which had significant fiscal implications. As we pointed out last year, the concept of a governing body to oversee data center operations is not new. In fact the HWDC has had such a body since its inception.

The Legislature adopted supplemental report language requiring an independent review of the data center's billing and cost recovery practices to be conducted under the direction of the DOF. The Legislature also adopted supplemental report language requiring the DOF to administratively establish a board of directors.

Requirements Have Not Been Met. Contrary to the Legislature's direction, an independent review has not been conducted and there are no apparent plans to conduct one; nor has a board of directors been established. Given the failure to comply with the Legislature's intent as expressed in supplemental report language, we recommend that the requirements be stated again, and that the Legislature adopt the following Budget Bill language in Item 2780-001-683:

1. There shall be an independent review of the data center's billing and cost recovery practices to (a) identify practices inconsistent with the state's policy governing cost recovery and (b) recommend changes to bring practices in line with the policy. This review shall be conducted by the Bureau of State Audits under the direction of the State Auditor. The State Auditor shall submit the audit report to the Legislature not later than January 5, 1996. The data center shall reimburse the bureau for the full cost of the review, including any administrative costs. The data center shall implement in an expeditious manner those recommendations contained in the State Auditor's report with which the data center agrees, and advise the Legislature in writing, not later than February 9, 1996, as to which recommendations will be implemented, and when, and the data

center's position on those recommendations it believes it should not implement.

2. The Director of the data center shall establish, within 60 days of the enactment of the 1995-96 Budget Act, a board of directors to review specific activities of the Stephen P. Teale Data Center. These activities shall include the review of (a) the data center's annual budget, (b) any proposed project, contract, or inter-agency agreement which has significant fiscal implications to the data center, and (c) changes to the data center's rates. The board shall make recommendations to the Director based on its review of such activities. The board may establish additional oversight responsibilities relating to the review of other data center activities. The board will consist of seven members, and shall include large, medium, and small clients of the data center. Board members will be selected by election, with each of the data center's client agencies having one vote. Those elected by the board will serve a one-year term. The chair of the board will be designated by the board members. The Legislature intends that the board be established and conduct its business within existing state appropriations.

Notification Requirements Should Be Reinstated

We recommend that the Legislature adopt Budget Bill language restoring the requirement that the data center notify the Legislature in advance regarding certain computer projects.

Beginning with the 1992 Budget Act, the Legislature has enacted Budget Act language each year requiring the data center to notify the Legislature, in advance, of certain procurements where the fiscal obligation would carry over into subsequent fiscal years. The 1995 Budget Bill, as introduced, does not contain the notification requirement. Given the potentially significant costs of multi-year procurements, we believe that such notification is important in keeping the Legislature informed as to significant data center procurements. For that reason, we recommend that the Legislature adopt the following Budget Bill language in Item 2780-001-683:

> The Director of the Teale Data Center shall not commit the data center to any fiscal obligation which would require an expenditure exceeding $250,000 for computer projects about which the Legislature has not been specifically informed in writing. The Director of Finance may authorize such an obligation to proceed no sooner than 30 days after notification in writing of the necessity therefore is provided to the chairpersons of the fiscal committees and the chairperson of the Joint Legislative Budget Committee, or not sooner than whatever lesser time the chairperson of the joint committee, or his or her designee, may in each instance determine.

Renegotiation of the Contract With the DMV

For Network Services Still Underway

We recommend that the data center advise the Legislature, at the budget hearings, as to the status and final outcome of its efforts to renegotiate the contract with the Department of Motor Vehicles (DMV) for the provision of network services.

Background. In 1993, the DMV sought bids for network services to replace an aging computer-based system used to handle electronic queries of the DMV databases. The TDC and two large private sector information technology firms were in contention for the bid. Shortly before bids were due, the DMV advised potential bidders that it would consider no bid which exceeded $18.8 million. On August 30, 1993, the TDC submitted a bid of $6.5 million. Neither of the private sector firms submitted a bid. The DMV determined that the TDC bid contained an error, and as a result the contract awarded to the TDC was for $5.5 million.

When Will Renegotiation Be Completed? The 1994 Budget Act directed the TDC to renegotiate its contract with the DMV to ensure that the DMV pays the data center the full cost of services provided. At the time this *Analysis* was being prepared, the data center advised that renegotiations had not been completed. We expect the result of these negotiations to be a reallocation of the data center's costs. Consequently, we recommend that the data center advise the Legislature, at the time of budget hearings, as to the status and final outcome of the contract and how its costs for the network services are being reallocated.

Funds for Computer Support May Not Be Required

We withhold recommendation on $1.7 million requested to support a computing system for the DMV pending review of a consultant's report which will address the necessity for the computing system.

The budget proposes $1.7 million to maintain and support a computer system purchased by the DMV for a DMV database redevelopment project which was put on hold in 1994. When the project was active, the TDC was selected to house and maintain the computer system to be used. Although the computer system is not being used as intended, it is being maintained until the DMV makes a decision as to what to do with it. In that regard, a report, anticipated in April 1995 from a consultant hired by the DMV to assess and advise it regarding the database redevelopment project, will address whether the computer system can be used or should be sold. If it is sold or relocated to another state agency, the TDC will not require funds to support the computer in 1995-96. On that basis, we withhold recommendation on $1.7 million budgeted in support of the system, pending review of the consultant's report.

Technical Budget Issues

We recommend a reduction of $5.4 million due to overbudgeting. (Reduce Item 2780-001-683.)

Our review of the data center's proposed budget indicates that some items have been overbudgeted and should be reduced. The specific reductions, which total $5.4 million, are as follows:

- $4.8 million in reduced revenue for support of the data center resulting from recent rate reductions.
- $600,000 because the State Teachers' Retirement System plans to budget less for data center services.

Data Center Drops Out of Performance Budgeting Pilot Project

The TDC is no longer a participant in the Performance Budgeting Pilot Project.

The TDC was one of the four original departments selected by the Department of Finance to participate in the Governor's performance budgeting pilot program. In adopting the 1994-95 budget, the Legislature indicated in supplemental report language that it was not prepared to support the data center's proposals for performance budgeting at that time, but encouraged the data center to provide an updated proposal for 1995-96. The administration advises that the data center is no longer a participant in the pilot program.

HEALTH AND WELFARE AGENCY DATA CENTER (4130)

The Health and Welfare Agency Data Center (HWDC) provides information technology services, including computer and communications network services, to the various departments and other organizational components of the Health and Welfare Agency. The center also provides services to other state entities and various local jurisdictions. The cost of the center's operation is reimbursed fully by its clients.

The budget proposes $103.3 million for support of the center's operations in 1995-96, which is an increase of $2.6 million, or 2.6 percent, over estimated current-year expenditures.

The Statewide Automated Welfare System Project Needs Further Review

We withhold recommendation on $20 million proposed for services to the Department of Social Services (DSS) for the Statewide Automated Welfare System (SAWS) project, pending legislative review of the revised costs and benefits of the project and several major issues regarding it.

The budget proposes $20 million and 39 positions for continued support of the SAWS project. These funds are contained in the budget request of the DSS and would be used to reimburse the HWDC for its cost of computer and related services associated with an interim system involving 14 counties.

Background. The SAWS project, estimated to cost in excess of $800 million over 12 years, is the most expensive application of information technology ever undertaken by the state. The purpose of the project is to provide a uniform, computer-based system for administering health and welfare programs in all counties except Los Angeles County, which has statutory authorization to implement its own system. The DSS plan approved by the administration and funded by the Legislature is based on an automated system currently in use by Napa County, known as NAPAS. According to the plan, counties would be phased-in with all counties operational on the new state system by the year 2000.

Statewide implementation would follow the completion and assessment of the 14-county interim SAWS pilot project, which is known as ISAWS.

Proposal Should Conform to Action Taken in DSS Budget. In our analysis of the DSS (please see the Health and Social Services section of this *Analysis*) we discuss several major issues regarding SAWS, including the interim project at the HWDC. In that discussion we withhold recommendation on *all* funds proposed for the SAWS project, pending a review by the Legislature of several major issues associated with this important project. Accordingly, we withhold recommendation on the $20 million requested to enable the HWDC to continue to provide services for the SAWS project.

Administration Funds Kiosk Program Despite Legislative Objections

We recommend deletion of $6.7 million and 13 positions requested to continue computer-based information kiosk programs because continuation of these programs as currently designed is inconsistent with prior legislative action. (Reduce Item 4130-001-632 by $6.7 million.)

Background. In 1994, the Governor proposed $7 million for the continued implementation of the Info/California and related kiosk projects. These projects are designed to deliver governmental information and services via free-standing computer-based kiosks stationed throughout the state. The Legislature considered the proposal, and determined that the project should be canceled. Accordingly, all funds for Info/California and related kiosk projects were deleted from the HWDC budget in the 1994 Budget Act.

On July 13, 1994, the Director of Finance notified the Legislature of his intention, pursuant to Section 27 of the Budget Act, to fully restore the deleted funds, citing contractual obligations as the basis for the action. On August 2 the Chair of the Joint Legislative Budget Committee wrote to the Director of Finance, recommending that the director *not* authorize the funds, because to do so would be inconsistent with the Legislature's action in passing the 1994 Budget Act. The issue was heard on August 30 by the Joint Legislative Budget Committee, and the hearing resulted in no change in the Legislature's original decision to delete the funds. Despite these repeated confirmations of the Legislature's intent, on September 15, 1994, the Director of Finance ordered the restoration of $7 million to the HWDC's budget. The administration has increased the number of kiosks to be deployed, from 15 when the Governor introduced his budget in January 1994, to 189 kiosks by the end of the current fiscal year.

Proposal Inconsistent With Prior Legislative Action. Notwithstanding the action of the Director of Finance to restore funding for the kiosk program in the current year, the Legislature has been clear and consistent in its actions to delete all funds for the project. Thus, we recommend deletion of $6.7 million and 13 positions proposed to continue the kiosk program in the budget year.

Alternative Approach for Providing Kiosk Services. If the Legislature wants to pursue a similar goal of delivering governmental information and services via computer-based kiosks, but in a different implementation strategy, an alternative approach is for the state to contract with private providers for kiosk services, rather than expending capital to acquire and operate a state-owned system.

Although the true effectiveness of kiosks to both government and the citizens it serves has yet to be determined, we believe that to be effective in any significant manner thousands of kiosks may have to be deployed in California, given the state's large, dispersed population. Consequently, continuing the HWDC's plan of state ownership carries significant cost implications and risks. Moreover, kiosk technology, like information technology in general, is constantly improving, with the result that every several months or so the cost of the technology relative to performance improves significantly. Given these factors, the ability to buy a kiosk service, and thus avoid a significant initial and ongoing capital investment, is on the surface an attractive alternative which warrants consideration. Other governmental jurisdictions throughout the nation, such as Texas, have decided to buy a service in lieu of establishing their own systems, and others are considering doing so. For all these reasons, should the Legislature decide to pursue a different implementation strategy, we recommend that contracting for a service be a part of any such consideration.

Data Center Should Plan Now For Less Costly Solutions

We recommend that the Legislature adopt supplemental report language requiring the data center to adopt and submit a plan to reduce customer dependence on costly mainframe solutions and increase the use of less costly "open" systems.

In our analysis of the budget of the Teale Data Center (please see the State Administration section of this *Analysis*), we note the continued trend at both the HWDC and the Teale Data Center to add expensive "mainframe" computer capacity. We note that this trend is counter to a nationwide trend toward reducing the dependence on the traditional mainframe platform. We conclude that it is important for each data center to develop an effective plan for reducing customer dependence on the mainframe by actively assisting clients to develop new computer applications on alternative platforms where practical, and to move existing applications, off of the mainframe, where doing so would reduce customer's costs. Accordingly, we recommend that the Legislature adopt supplemental report language directing the HWDC to adopt such a plan and provide a copy to the Legislature by December 1, 1995.

Specifically, we recommend the following language:

> The data center shall adopt a plan to reduce customer dependence on traditional mainframe solutions by (1) assisting customers to develop new applications, where feasible, on alternative systems, and (2) moving existing applications off of mainframes where doing so would reduce customer costs. The data center shall submit the plan to the Legislature by December 1, 1995.

Internet Workload Not Justified

We recommend deletion of $236,000 and two positions budgeted in support of Internet activity, because the case for additional resources has not been made. (Reduce Item 4130-001-632 by $236,000.)

The budget includes $236,000 and two positions to support workload associated with the Internet—commonly referred to as the information superhighway. According to the HWDC, these resources are necessary to expand the capabilities of the HWDC to help its client agencies distribute computer-based information about their programs to the public via the Internet.

Although we support facilitating public access to state-maintained information, the department has been unable to demonstrate the amount of workload which may materialize, nor that it is unable to accommodate that workload with existing staff. For these reasons, we recommend deletion of $236,000 and two positions budgeted for Internet-related support.

Legislative Oversight: Consolidation Study Not Completed

The administration did not comply with a legislative directive requiring the Health and Welfare Agency Data Center and the Department of Finance (DOF) to study consolidation of state data centers.

The *Supplemental Report of the 1994 Budget Act* directed the HWDC to cooperate with the DOF to produce a study addressing the feasibility of consolidating state data centers to reduce costs and improve computing effectiveness. The study was to have been submitted to the Legislature by December 30, 1994; however, no such study has been received. According to the HWDC, the administration's position on this matter was addressed in (1) the October 1994 report by the Governor's Task Force on Government Technology and Procurement and (2) the DOF's response to a report issued by the State Auditor in December 1994 entitled *The State Needs to Reengineer Its Management of Information Technology*.

Although the Governor's task force report recommends consolidating "utility type" state information technology operations, particularly the data centers, the report does not constitute a study of the issue. In fact, the report acknowledges that the concept of data center consolidation should be studied by a new state Chief Information Officer to determine whether the data centers are viable candidates for consolidation. We were unable to find any mention of data center consolidation in the DOF's response to the State Auditor's report. Consequently, the Legislature's question as to the feasibility of data center consolidation remains unanswered.

DEPARTMENT OF PERSONNEL ADMINISTRATION (8380)

The Department of Personnel Administration (DPA) manages the *nonmerit* aspects of the state's personnel system. (The State Personnel Board manages the merit aspects.) The Ralph C. Dills Act provides for collective bargaining for most state employees. Under this act, the DPA is responsible for (1) reviewing existing terms and conditions of employment subject to negotiation, (2) developing management's negotiating positions, (3) representing management in collective bargaining negotiations, and (4) administering negotiated memoranda-of-understanding (MOUs). The DPA also is responsible for the compensation, terms, and conditions of employment of managers and other state employees not represented in the collective bargaining process.

Overview of the Budget Request

The budget proposes additional funds for DPA programs, primarily from reimbursements from other state departments.

The budget proposes total expenditures of $20.2 million for support of the department in 1995-96. The principal funding sources are:

- $5.3 million from the General Fund.
- $8.9 million from reimbursements from other state departments.
- $5.2 million from the Deferred Compensation Plan Fund.

The proposed expenditures for DPA support are $5.5 million, or 38 percent, above estimated current-year expenditures. Of this amount, $2.8 million from the Deferred Compensation Plan Fund reflects a change in accounting for the contracted trustee/recordkeeping costs of deferred compensation programs. These costs were not fully reflected in current- or prior-year budget totals, due to a contractual technicality. Thus, in this instance, the budget totals have increased while true program costs have not.

The budget proposes no change in the level of General Fund support for the DPA. Almost all of the remaining budget increase is in the form of additional reimbursements expected from other state departments. These increased reimbursements fund the following budget change proposals:

- $1.9 million and 30.1 personnel-years to consolidate the state's efforts in employee adverse action cases and other labor litigation. Essentially, the proposal involves a shift of workload and resources to the DPA from departments that have been hiring outside legal counsel.
- $285,000 and two positions to develop and implement an alcohol/drug testing program for commercially licensed truck drivers employed by the state, to comply with federal law.
- $250,000 and one position to establish a "Continuous Improvement" program to assist departments in improving service to the public (also known as "total quality management"). Although the DPA envisions this as an ongoing program, its initial request is for a limited-term position (two years) since there is uncertainty as to the extent to which the program will attract paying customers (state departments).

New Collective Bargaining Agreements Under Negotiation

We recommend that the DPA report to the fiscal committees during budget hearings on the administration's collective bargaining proposals, the status of negotiations, and the format/nature of fiscal information to be provided to the Legislature with the completed bargaining agreements.

The DPA was scheduled to begin negotiations in January with the 21 bargaining units that represent rank-and-file state employees (other than higher education) for new MOUs governing compensation and other terms and conditions of employment. These MOUs will replace the existing MOUs that are to expire June 30, 1995. The Ralph C. Dills Act directs the administration and employee representatives to endeavor to reach agreement before adoption of the Budget Act for the ensuing year. The act further specifies that provisions of MOUs requiring the expenditure of funds be approved by the Legislature in the annual Budget Act before the provisions may take effect. Historically, however, agreements often have not been reached in time for the Legislature's consideration as part of the budget process.

In recognition of the statutory intent and the importance of these negotiations for the 1995-96 budget, we recommend that the DPA report to the fiscal committees during budget hearings on the administration's collective bargaining proposals, the status of negotiations, and the format/nature of fiscal information to be provided to the Legislature with the completed bargaining agreements.

Our overview of employee compensation issues in this *Analysis* includes related discussion and recommendations regarding state employee collecting bargaining.

BOARD OF CONTROL (8700)

The Board of Control (BOC) oversees diverse activities including state regulation and management of claims under the following programs: Citizen Indemnification (also known as the Victims of Crime Program), Civil Claims Against the State, and Hazardous Substance Claims. The Victims of Crime Program (VOC) accounts for about 99 percent of the board's total expenditures.

The budget proposes expenditures of $123.2 million in 1995-96, including $2.6 million from the General Fund. This is $7.2 million, or 5.5 percent, less than current-year estimates. The difference is, in part, the result of a General Fund augmentation for 1994-95 to pay the costs of county claims for special elections pursuant to Ch 39/93 (AB 37, Johnson).

Fund Transfer Will Limit Shortfalls in Victims Program, But at a Cost to the General Fund

We recommend that the board report during budget hearings on the status of the funding of the Victims of Crime Program. Specifically, the board should report on (1) the status of Victims of Crime claims and its estimate of any shortfall for the current and the budget year, (2) the status of the Penalty Assessment Fund which is proposed to shift an additional $30.5 million to the Restitution Fund, and (3) the board's proposed actions for continuing to reduce program costs and increase program revenues.

Background. The VOC Program compensates those persons who (1) are injured and suffer financial hardship as a result of crimes of violence, (2) suffer financial hardship because a family member was injured as a result of crimes of violence, or (3) sustain damage or injury while performing acts that benefit the public. About 80 percent of the cost of claims is for noninsured medical and mental health expenses. The remaining costs are for wage loss, funeral expenses, and rehabilitation expenses.

The program is primarily funded from the Restitution Fund and federal funds. The Restitution Fund receives its revenues from restitution fines and penalty assessments imposed on persons who violate criminal or traffic laws.

Increasing Costs Have Exceeded Revenues. The VOC Program has had a history of expenditures exceeding revenues since 1990-91. Prior to 1992-93, the shortfall in revenues was covered by reserves in the Restitution Fund.

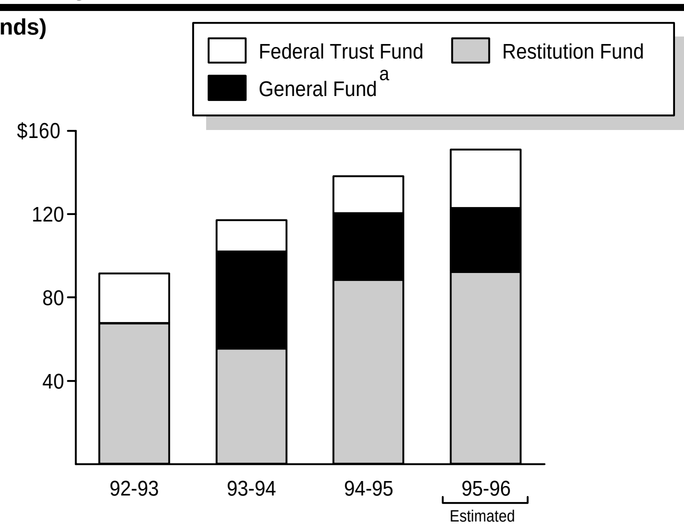
By 1992-93, the reserves in the Restitution Fund were depleted and the program experienced a deficit totaling $18.4 million. Since that year, claims have continued to exceed revenues requiring augmentations from the General Fund and the Driver's Training Fund. The program would have a shortfall of at least $30 million in the budget year if the Governor's Budget did not propose transferring Driver's Training Fund monies to it. Under other circumstances, surplus monies in the Driver's Training Fund are transferred to the General Fund.

Figure 22 shows the amounts and sources of funding for paying claims since 1992-93.

Figure 22

Sources of Funding for Victims of Crime Program 1992-93 Through 1995-96

(In Thousands)



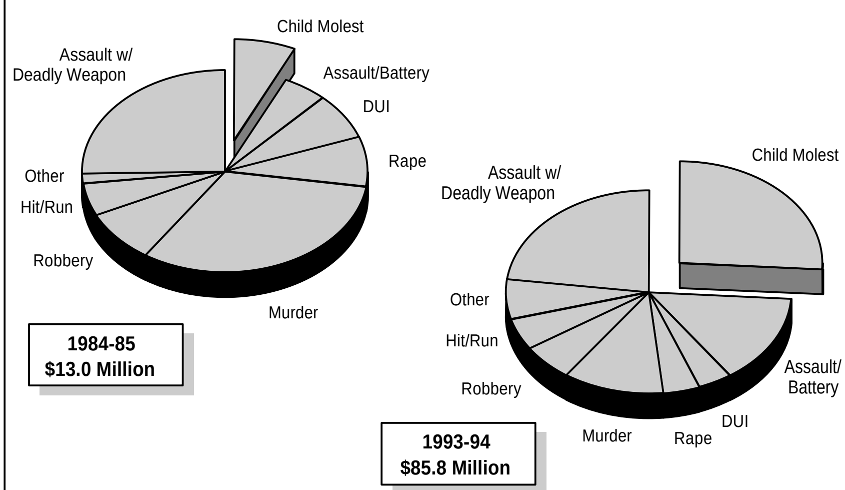
[a] Includes monies that would otherwise have been transferred to the General Fund.

VOC Costs Have Increased, but Revenues Have Not. The basic problem with this program is that program expenditures have increased far faster than program revenues. Since 1987-88, expenditures have increased at an average rate of 12 percent each year while revenues to support the program have increased at an average rate of 10 percent. Revenues are tied to a statutory formula and not an evaluation of program operation. Since 1987-88, the number of claims for all covered crimes has increased except for "hit and run" cases.

The largest growth in victim claims is for victims of child molestation (including related family members). These claims grew from $900,000 in 1984-85 to over $22 million in 1993-94, an almost 25-fold increase. These claims have grown dramatically in response to expanded program eligibility. Figure 23 compares the payments the board made in 1984-85 by crime category to those payments made in 1993-94.

Figure 23

Victims of Crime Program Payments By Crime Category 1984-85 and 1993-94



Actions Taken to Reduce Program Shortfalls. There are two primary options available to reduce program shortfalls. First, actions can be taken to reduce program benefit payments, this includes restricting who can claim benefits and limiting the amounts paid to claimants. The other option is to increase program revenues. Increasing program revenues can take the form of raising minimum restitution fine amounts, expanding who can be assessed fines, and improving the collection of fines.

Recent Legislative Actions. The Legislature has recently taken action to both reduce benefit payments and increase revenues. For example, the

Legislature enacted Ch 682/92 (SB 1444, Presley) which provided an additional $5 million revenue to the Restitution Fund. Chapter 780, Statutes of 1993, (SB 644, Presley), allowed the board to modify benefits for long-term income or loss of support payments, and for mental health payments. The board estimates that these changes will save up to $6 million in 1994-95, and $5 million in 1995-96. In addition, Ch 295/93 (SB 774, Leslie) allowed the board to place liens against those owing restitution fines resulting in additional revenue of almost $1 million.

Board Cost Containment Actions. Since 1992, the board has taken a variety of actions to reduce program and administrative costs, and to increase revenues. The board has adopted the State's Workers' Compensation Fee Schedule as the maximum rate of reimbursement for injury claims and estimates that this action has saved more than $3 million annually.

The board has also begun discounting in-patient hospital bills by 25 percent. Providers are willing to accept the reduced reimbursements in exchange for prompt payment of their claims. The board estimates that this discounting resulted in savings of more than $5 million annually. The board reports that it will realize a further $4 million in savings per year by reviewing and preapproving certain types of therapy programs.

Board Actions to Increase Revenues. The board also reports that it has taken a series of actions to increase the collection of revenues. The board has met with judges to inform them of their options in assessing restitution fines and penalty assessments, and with county officials who are responsible for the collection of fines, to develop strategies for improving collections.

Addressing Funding Shortfalls. Notwithstanding the actions taken to reduce program costs and increase revenues, and a substantial increase in the amount of federal funding—an increase of $10.2 million or 36 percent between the current- and budget-years—the board would have a $30 million shortfall in 1995-96, based on the level of expected claims. The Governor's Budget proposes to augment the Restitution Fund with a $30.5 million transfer from the Driver's Training Penalty Assessment Fund to eliminate the expected shortfall. For 1994-95, $28.5 million was transferred from the same fund to the Restitution Fund to alleviate a similar shortfall.

The Administration's Proposal Will Reduce Budget-Year Shortfalls, but Not Eliminate Future Funding Problems. The administration's budget proposal will address the funding shortfall for the budget year. In recent years, however, the bulk of revenues from the Driver's Training Fund has been transferred to the General Fund.

Thus, the budget proposal will result in a loss of revenue that might have otherwise been transferred to the General Fund.

Furthermore, the budget proposal does not address the structural funding problems of the program or define how the administration will deal with future funding shortfalls. The funding shortfalls for 1996-97 will be greater than for the budget year. This is because Restitution Fund revenues are not expected to increase sufficiently to pay all claims, and because federal funding will decrease by at least $10 million in 1996-97. We estimate that the potential VOC Program shortfall for 1996-97 could be as much as $40 million.

Options for Reducing Future Problems. The Legislature has several options for reducing future program shortfalls. These include:

- ***Limit Payment Amounts.*** The Legislature could enact legislation that allows the board to adjust the amounts it will pay towards victims' claims based on available program revenue. Using Restitution Fund and federal revenue estimates and projected claims, the board could pay a percentage of the value of claims based on a ratio of the total revenue available. The Legislature could set priorities regarding which claims should receive higher percentages of funding than others. This would eliminate funding shortfalls, and allow all claims to receive some funding, and higher priority claims would receive more.

- ***Transfer Funds.*** The Legislature could consider permanently transferring revenues from the Driver's Training Fund to the Restitution Fund. This action would provide an estimated additional $30 million in revenues for paying claims. However, it would not guarantee that sufficient funds would be available for paying future claims. Furthermore, this action would result in a loss of revenues that have historically been transferred to the General Fund.

- ***Establish Restitution Fine for Diversion Programs.*** The Legislature could enact legislation that would require those who receive diversion programs for driving-under-the-influence (DUI), substance abuse, and domestic violence, in lieu of convictions, be charged a $100 to $1,000 restitution fine. When an offender completes a diversion program, no restitution fine is assessed. An offender in a similar circumstance, but who did not receive diversion, generally must pay a restitution fine. In 1993, 10 percent of all adult felony arrests, over 49,000, were disposed of with successful completion of a diversion program. We estimate that restitution fine revenue from these individuals could total over $20 million annually.

- ***Collect Restitution Fees From Parolees.*** The Legislature could enact legislation requiring the California Departments of Corrections and the Youth Authority to collect restitution fines from parolees. Current law requires that both the Department of Corrections (CDC) and the Youth Authority collect restitution fines from inmates and wards while they are incarcerated. The parole authorities could collect payments from those individuals who did not pay while incarcerated, but may have the ability to pay while on parole.

- ***Establish Restitution Fines for Parole Violators.*** The Legislature could enact legislation that requires a restitution fine be assessed for all parole violators who are returned to the CDC or Youth Authority for a technical parole violation. These parolees do not appear in court, but rather have their parole revocated by paroling authorities. If they were convicted in court they may have had a restitution fine assessed.

- ***Reduce Administrative Costs.*** The board could reduce its administrative cost of processing claims. This could be accomplished in a number of ways, such as better use of automation, revising and streamlining the claims review process, and limiting duplicative claims reviews.

Analyst's Recommendation. Because of continuing funding shortfalls and the limited actions the administration has taken to address the long-term structural funding problems for the program, we recommend that the board report during budget hearings on the status of the funding of the VOC Program. Specifically, the board should report on (1) the status of VOC claims and its estimate of any shortfall for the current or the budget year, (2) the status of the Penalty Assessment Fund which will shift an additional $30.5 million to the Restitution Fund, and (3) the board's proposed actions for continuing to reduce program costs and increase program revenues.

DEPARTMENT OF FINANCE (8860)

The Department of Finance (DOF) advises the Governor on the fiscal condition of the state, assists in developing the Governor's Budget and legislative programs, evaluates the operation of the state's programs, and provides economic, financial, and demographic information. In addition, the department oversees the operation of the state's accounting and reporting systems and the state's use of information technology (IT).

The Governor's Budget proposes expenditures of $28.9 million ($22.1 million from the General Fund) to support the activities of the DOF in 1995-96. This reflects an increase of $1.5 million, or 5.4 percent, above estimated current-year expenditures.

Information Technology Oversight to be Transferred

We withhold recommendation on $2 million proposed to fund the operations of the Office of Information Technology (OIT), pending receipt and review of a plan to create a new Office of the Chief Information Officer.

The proposed budget includes $2 million to fund the operations of the OIT, an office which has both broad and specific responsibilities to ensure the state's effective uses of IT.

Three Separate Reports Review Performance of the OIT. In the spring and summer of 1994, we issued reports on the state's use of information technology. We concluded that several fundamental problems inhibit state departments from making the most effective use of information technology. We also concluded that the OIT had failed to fulfill its responsibilities and recommended the enactment of legislation transferring the responsibility for statewide information technology to a new organization reporting directly to the Governor. In September 1994, the Governor's Task Force on Government Technology Policy and Procurement issued a report which found that the OIT "does not add significant value in either IT advocacy or oversight." The task force recommended that the office be eliminated in favor of a new agency headed by a cabinet-level Chief Information Officer (CIO) who would report directly to the Governor. Finally, in December 1994, the Bureau of State Audits released a report that found that the OIT " . . . has been ineffective in its role of providing statewide leadership." The report recommended the elimination of the office and the creation of a new cabinet-level office headed by a CIO.

Governor Indicates OIT to be Eliminated. In his *1995-96 Governor's Budget Summary,* the Governor proposes to hire a CIO in early 1995, who will be a senior member of his administration. According to the budget summary, the CIO will be responsible to design a new Office of the State Chief Information Officer, which by July 1, 1995 will inherit the responsibilities of the OIT. The summary indicates that funding for the new CIO's operations will be redirected from existing resources, and that the CIO will present a fiscal plan for the office to the Legislature prior to the May Revision.

Pending the receipt and review of that plan, we withhold recommendation on the $2 million proposed for the OIT.

Uncertainty About Performance Review Positions

We withhold recommendation on $501,000 and seven positions proposed to conduct performance audits and reviews, pending clarification of the proposal at the time of budget hearings.

The budget includes $501,000 and seven positions to conduct performance audits and reviews of state agencies. The State Government Strategic Planning and Performance Review Act (Ch 779/94, AB 2711, Valerie Brown) requires the DOF to (1) determine which state agencies need to develop or update a strategic plan, and (2) recommend a plan for conducting performance reviews of those agencies which have completed strategic plans. Based on our review of the request, it is not clear whether the seven positions will be used to meet the requirements of Chapter 779 or to conduct performance audits for other purposes. Thus, we withhold recommendation on the request, pending clarification from the DOF during budget hearings on its plans for conducting performance reviews.

Performance Budgeting Pilot Program

In 1993, the Governor proposed a performance budgeting pilot program involving four departments. The program was subsequently enacted in statute in Ch 641/93 (SB 500, Hill) as the Performance and Results Act of 1993. The DOF provides oversight of the program. Since the program was established, the number of departments participating in the program has been increased to five.

To date, there has been a considerable investment of state resources within the five pilot departments to implement performance budgeting, but results are still pending. Because the program affects multiple agencies and the administration has the authority to expand it, we review the performance budgeting pilot program in the Crosscutting Issues section of this chapter.

MILITARY DEPARTMENT (8940)

The Military Department is responsible for the command and management of the California Army and Air National Guard. To support the operations of its force of 3,480 personnel, the department maintains a headquarters complex in Sacramento, 127 armories, 44 maintenance shops, and 10 air bases throughout the state.

The missions of the National Guard are to provide combat-ready forces to the federal government at the direction of the President, to contribute emergency public safety support at the direction of the Governor, and to otherwise assist the community as directed by proper authorities.

The Governor's Budget for 1995-96 proposes expenditures of $475 million by the department. Of that amount, $455 million would come from the federal government, although only $40.8 million would be appropriated through the Budget Bill. The Budget Bill would also authorize the expenditure of $18.5 million from the state General Fund for the department, or about the same amount provided in the budget for the current fiscal year.

Border Guard Operations Are Not State Responsibility

We recommend deletion of $1.3 million from the General Fund requested for support of National Guard activities along the California-Mexico border because the proposed activities are not a state responsibility and because the federal government has recently increased its law enforcement activities along the border. (Reduce Item 8940-001-001 by $1.3 million.)

Background. The Governor's proposed budget for 1994-95, as revised in May 1994, called for the expenditure of $2.6 million from the state General Fund to support the deployment of 53 National Guard personnel in temporary State Active Duty status to help the U.S. Border Patrol increase its effectiveness in fighting the trafficking of drugs and illegal immigration across the California-Mexico border. The project was termed "Team Goalkeeper." The mission of the state-supported border force was not to directly apprehend drug traffickers or persons crossing the border illegally. Rather, National Guard forces were to help maintain roads, drive and maintain vehicles, provide photo surveillance and intelligence analysis, and offer communications support that would free-up sworn U.S. Border Patrol agents to reduce drug trafficking and illegal border-crossings.

The Legislature approved the $2.6 million for the project in the 1994 Budget Act, but provided only $1.3 million from the General Fund, and another $1.3 million in federal funds for the border activity, assuming the department could obtain the federal funding.

No Federal Funds in Current Year. The deployment of National Guard forces began in September and within several months was phased-in to reach the full staff complement of 53 that had been authorized. However, the department did not obtain the proposed federal funding, and does not anticipate doing so before the end of the current year. As a result, the department has nearly exhausted the $1.3 million General Fund appropriation for Team Goalkeeper and now says it expects to pull out the entire force by March or April 1995.

Governor's Budget Requests Same Level of Funding for 1995-96. The Governor's Budget proposes to reinstate a force of 53 National Guard personnel at the border beginning this summer, relying upon the same cost-sharing arrangement with the federal government that was approved in the budget for the current year. The department indicates that, with a longer lead time, it believes that it will succeed in obtaining these additional funds. However, the department has yet to identify the specific source of federal funds and the amounts it expects to receive.

State Funding Not Justified. We believe that the proposal is not justified for two reasons. First, enforcing the law along the California-Mexico border is a *federal responsibility*, not a state responsibility.

Second, since Team Goalkeeper went into operation, federal authorities have announced plans to increase the number of federal agents assigned to California in an effort to deter illegal border-crossings. Using funds provided as part of the federal crime bill, the U.S. Department of Justice announced in early January 1995 that the U.S. Immigration and Naturalization Service will assign 598 additional employees to California to enforce the laws against illegal immigration, including an additional 200 Border Patrol agents in the San Diego region. The agents are expected to arrive in increments of 50 every three months. When all of the new agents are in place, the San Diego regional force will be 1,573 agents, or a 58 percent increase in the space of two years.

The significant recent increase in federal efforts to control illegal immigration means that the state's withdrawal of National Guard forces should not hurt efforts to control the California-Mexico border. Federal authorities are bringing in many more new agents than would be lost through the withdrawal of National Guard personnel. In fact, as we indicated above, National Guard personnel are already expected to cease operations at the border by April because the current-year appropriation will run out.

For these reasons, we recommend that the request be denied, for a General Fund savings of $1.3 million.

DEPARTMENT OF VETERANS AFFAIRS (8950) AND VETERANS' HOME OF CALIFORNIA (8960)

The Department of Veterans Affairs (DVA) provides services to California veterans and their dependents, and to eligible members of the California National Guard. The principal activities of the DVA include: (1) providing low-interest home and farm loans to qualifying veterans using proceeds from the sale of general obligation and revenue bonds; (2) assisting eligible veterans and their dependents in obtaining federal and state benefits by providing claims representation, county subventions, and direct educational assistance to qualifying dependents; and (3) operating the California Veterans' Home in Yountville, which provides approximately 1,125 California veterans with several levels of medical care, rehabilitation services, and residential services.

The budget proposes total expenditures of $365 million for the DVA in 1995-96. This is $14.6 million, or 3.8 percent, less than the projected current-year expenditures. Total expenditures from the General Fund during the budget year would be $28.7 million, almost exactly the same amount as in the current year.

The proposed decrease in the overall budget is due primarily to fluctuations in the amount of bond funds available to provide farm and home loans to veterans.

No Funding in Budget to Operate New Barstow Home

The department's proposed budget does not include funding necessary to activate the new Barstow veterans' home now under construction; the administration indicates it will submit the funding request later in the budget process.

In addition to its existing Yountville home, the DVA is currently constructing a second 400-bed veterans' home in Barstow in San Bernardino County. Although the $32 million facility is scheduled to open during the upcoming budget year (in January 1996), funding to support and operate the new facility has not been included within the proposed budget. The DVA indicates that the complex task of developing operating plans for Barstow will soon be completed and that a Finance Letter will be submitted later in the budget process requesting the funds needed to open the new veterans' home.

Last year, the department had estimated that the second home would cost $8.5 million annually to operate and cost another $2.5 million in annual debt-service payments, for a total annual cost of $11 million. However, the final proposal could be significantly different. This is because the Legislature, in supplemental language to the 1994 Budget Act, directed DVA to provide separate options for the activation of 100, 200, 300, and 400 beds of the total under construction. The department advises that these options are to be included in a report submitted to the Legislature in late January or early February.

HEALTH AND DENTAL BENEFITS FOR ANNUITANTS (9650)

This appropriation provides for the state's contribution toward monthly health and dental insurance premiums for annuitants of the Judges', Legislators', District Agricultural Employees', and Public Employees' Retirement Systems, as well as specified annuitants of the State Teachers' Retirement System. The program provides eligible members with the option of selecting insurance coverage from as many as 18 state-approved health plans (depending on where an annuitant lives).

Each year the Legislature sets the maximum contributions by the state for monthly health insurance premiums in Control Section 4.00, based on a statutory formula described in our analysis of that section. State contributions for dental premiums are established annually by the Department of Personnel Administration (DPA).

Overview of the Budget Request

We withhold recommendation on the $295.7 million General Fund request for Health and Dental Benefits for Annuitants pending final determination of premium rates.

The budget proposes total expenditures of $295.7 million from the General Fund for health and dental benefits for annuitants in 1995-96. This is $4.8 million, or 1.6 percent, less than estimated expenditures for this purpose in the current year. A drop in the state contributions prescribed by the statutory formula (because the relatively expensive PERSCARE health plan is no longer included in the formula) more than offsets expected increases in the numbers of covered annuitants. However, the final determination of the contributions required by statute and, therefore, the amounts to be appropriated in this item, must await the outcome of the negotiations over health premiums currently under way between the state and providers. Pending final determination of these premium rates, we withhold recommendation on the amount requested under this item.

Figure 24 (see next page) displays actual, estimated, and budgeted expenditures for annuitant health and dental benefits for the three fiscal years starting with 1993-94.

Figure 24

Health and Dental Benefits for Annuitants General Fund Expenditures 1993-94 Through 1995-96

(In Thousands)

Program	1993-94 Actual	1994-95 Estimated	1995-96 Budgeted
Health	$270,307	$273,387	$267,111
Dental	26,557	27,100	28,590
Totals	**$296,864**	**$300,487**	**$295,701**

CONTROL SECTION 3.60

PERS Employer Contribution Rates

We withhold recommendation on employer contribution rates for retirement benefits pending final determination of the actual rates to be applied in the budget year and receipt and review of information regarding the basis for the actuarial assumptions underlying the determined rates.

This control section specifies the contribution rates for the various retirement classes of state employees in the Public Employees' Retirement System (PERS). The section also authorizes the Department of Finance (DOF) to reduce any appropriation in the Budget Bill that is in excess of the amount required as a result of any reductions in these rates. In addition, the section authorizes the DOF to require the State Controller to offset these contributions with surplus funds in the employer accounts of the retirement trust fund.

Under current law, the PERS is responsible for developing employer contribution rates each year based on actuarial analyses. At the time this *Analysis* was prepared, a final determination of these rates had not been made.

Consequently, we withhold recommendation pending final determination of 1995-96 rates and receipt and review of information from the PERS regarding the basis for the actuarial assumptions underlying the determined rates. This information is typically available in March or April.

CONTROL SECTION 4.00

State Contribution Rates for Health Insurance Premiums

We recommend that the Legislature set health insurance contribution rates for state employees based on either existing law or new collective bargaining Memorandum of Understanding (MOUs) ratified by the Legislature. Further, we withhold recommendation on those rates, pending final negotiations between the state and health insurers.

Government Code Section 22825.1 calls for the Legislature to set maximum amounts for monthly state payments for health insurance for state employees and annuitants (retired employees and eligible survivors) in the annual Budget Act. Control Section 4.00 of the Budget Bill is for that purpose.

Contribution Rates on Behalf of Annuitants. The amounts proposed for annuitants are based on the following calculation specified in Section 22825.1, known as the 100 percent/90 percent formula:

- For individuals, 100 percent of the weighted average of health insurance premiums for the four benefit plans with the highest combined enrollments of employees and annuitants.
- For family members, 90 percent of the same weighted average calculation for the additional premiums needed for enrollment of family members.

The amounts proposed for annuitants are below the amounts calculated under the statutory formula for the 1994 Budget Act, as shown in Figure 25. The merger of two health plan providers (Qual-Med and Health Net), as well as declining enrollments in the PERSCARE plan, has caused the less expensive Qual-Med/Health Net plan to replace the PERSCARE plan as one of the four plans used in the statutory calculation. The budget estimates resulting state savings of almost $20 million. (Final determination of the state's contribution rates, however, will depend on the outcome of premium negotiations with health plan providers. These negotiations were still under way at the time this *Analysis* was prepared.)

Contribution Rates on Behalf of Employees. The 100 percent/90 percent formula originally applied to employees as well as annuitants. However, Government Code Section 22825.15, added in

Figure 25

Control Section 4.00
Maximum State Contributions Toward
Monthly Health Premiums for Annuitants
1994-95 and 1995-96

Enrollment Status	1994-95	1995-96	Change
Individual	$182	$162	-$20
Individual plus one family member	342	308	-34
Individual plus two or more family members	415	395	-20

1991, provides that the maximum state contributions be determined for (1) represented employees through collective bargaining for new MOUs and (2) nonrepresented employees by the Department of Personnel Administration (DPA), in both cases subject to appropriation of funds by the Legislature in the annual Budget Act. If, however, an MOU does not specify these rates or an MOU is not in effect, presumably the 100 percent/90 percent formula would kick in as the "default rates."

Figure 26 compares the amounts proposed in the control section for employees and annuitants. For employees, the figure reflects the amounts negotiated under collective bargaining MOU covering the three-year period ending June 30, 1995. (The DPA established identical amounts for nonrepresented employees.) It is unclear why the administration has put in these employee rates for 1995-96 as opposed to the best current estimate of what the 100 percent/90 percent formula calls for—as evidenced by the lower annuitant rates shown in Figure 26.

Figure 26

Control Section 4.00
Proposed Maximum State Contributions
Toward Monthly Health Premiums—1995-96

Enrollment Status	Employees	Annuitants
Individual	$174	$162
Individual plus one family member	323	308
Individual plus two or more family members	410	395

Since the collective bargaining MOUs for 1995-96 currently are under negotiation between the DPA and employee representatives, the Budget Bill includes the amounts currently in effect as "place-holders." We believe it is preferable, however, to use the amounts specified by the 100 percent/90 percent formula instead. If new MOUs are *not* negotiated by the DPA and ratified by the Legislature before enactment of the Budget Bill, under current law the 100 percent/90 percent formula would apply for employees after the current MOUs expire June 30, 1995. For this reason, we recommend that the Legislature conform the Control Section 4.00 amounts for employees to either (1) the amounts specified by the statutory formula, if new MOUs are not completed in time for consideration in the budget process, or (2) lower amounts, called for in any new MOUs ratified by the Legislature.

Premiums for 1995-96 Not Yet Determined. At the time this analysis was prepared, the Public Employees' Retirement System was negotiating with health care providers to establish 1995-96 health insurance premiums for the state. The appropriate state contributions, based on the 100 percent/90 percent formula, therefore could change. Consequently, we withhold recommendation on Control Section 4.00, pending final determination of the health insurance premium rates.

LIST OF FINDINGS AND RECOMMENDATIONS

		Analysis Page
7.	**New Collective Bargaining Agreements Under Negotiation**. The DPA should report to the fiscal committees during budget hearings on the administration's collective bargaining proposals, the status of negotiations, and the format/nature of fiscal information to be provided to the Legislature with the completed bargaining agreements.	H-30
8.	**Strengthening Legislature's Collective Bargaining Oversight.** We recommend that the Legislature adopt policies to assure that the Legislature will have the opportunity to fully review proposed collective bargaining agreements. For collective bargaining proposals in future years, we recommend that the Legislature enact legislation incorporating the policies into law, along with a requirement for the DPA to report changes in the agreements to the Legislature.	H-30
9.	**Budget Augments Current-Year Spending.** The administration intends to authorize departments to spend at rates that would create appropriation deficiencies ($1.7 million General Fund, $28.9 million other funds) in the current year for costs associated with the January 1, 1995 employee pay increase. This proposal should be submitted to the Legislature through separate legislation rather than through a notification process.	H-32
10.	**Changes in Pay-for-Performance Policy**. Since last year's introduction of pay-for-performance for managers in civil service, the DPA has revised program details and extended coverage to supervisors in civil service. Furthermore, the Governor has directed the DPA to try to extend pay-for-performance to rank-and-file workers through current collective bargaining negotiations.	H-33
11.	**Disappointing Results from Manager/Supervisor Reductions.** In the 1994 Budget Act the Legislature adopted the Governor's proposal to reduce the numbers of managers and supervisors by a statewide average of 10 percent and reflected the administration's estimated savings of $150 million ($75 million General Fund) in 1994-95. The administration's implementation of this proposal, however, has resulted in only a $4 million savings from all funds	H-34

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($1 million from the General Fund).

Office of Emergency Services

12. **Request for 350 Positions.** Withhold recommendation on $20.2 million requested to establish 350 new positions pending further review. H-39

13. **State's Share of Local Disaster Costs.** Withhold recommendation on $75 million proposed to reimburse local government pending additional justification. H-40

14. **Fiscal and Performance Audit.** Recommend adoption of supplemental report language requiring an independent and thorough fiscal and performance review of the OES. H-40

State Controller

15. **Unclear Basis for Additional Audit Activity.** Withhold recommendation on $501,000 and seven new positions to conduct audits, pending review of revised proposal. H-45

State Board of Equalization

16. **Only One Bid Received on Computer Redesign and Migration Project.** We recommend that the BOE report to Legislature during budget hearings on how the bidding process met state competitive bidding requirements and how the award of the contract was beneficial to the state. H-46

17. **MSAs and Other Price Increases.** We recommend that the Legislature not approve a $4.2 million augmentation associated with MSAs, employer retirement rate contribution adjustment, and postage rate increase unless the BOE demonstrates that these cannot be absorbed within discretionary portions of the budget that do not affect tax revenues. H-48

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Secretary of State

18. **Information Management Plan.** The Secretary of State has begun implementation of a plan to upgrade its information technology. H-50

19. **Inappropriate Expenditures From Business Fees Fund. Reduce Item 0890-001-228 by $201,000 and Augment Item 0890-001-001 by $201,000.** Recommend that investigation unit in Election's Division be supported by General Fund. H-52

State Treasurer

20. **Consolidation of Financial Authorities.** Recommend that the Treasurer report during budget hearings on a plan to consolidate financial authorities in order to generate savings. H-53

Franchise Tax Board

21. **State Risk in Procurement Requires Regular Reporting.** We recommend that the FTB be required to provide the Legislature an annual report of revenues collected as part of the Bank and Corporation Tax collecting computing system procurement and the amount of debt retired. H-56

22. **General Fund Not Appropriate, or Necessary, to Fund Child Support Collections.** We recommend that the Legislature reduce the General Fund support of the FTB expansion of the child support collection program and fully fund the program out of federal reimbursements and county incentive payments. (Reduce Item 1730-001-001 by $1 million and increase reimbursements by $1 million.) H-59

23. **Baseline Adjustments Should be Absorbed.** We recommend that the Legislature not approve a $6.3 million augmentation associated with Merit Salary Adjustments and other price increases until the FTB demonstrates that these costs cannot be absorbed within discretionary portions of the budget that do not directly affect tax revenues. H-60

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Department of General Services

Improving Fleet Operations

24.	**Vehicle Replacement.** Withhold recommendation on $6.7 million requested to replace state vehicles pending plans to implement a reservation system and open fleet operations to competitive bidding, and an estimate of savings obtainable by centralizing fleet operations.	H-67
25.	**Alternative Fuel Vehicles.** Converting the state's fleet to alternative fuel vehicles, consistent with federal and state policy, will result in added costs as high as $40.5 million through 1999.	H-69

Telecommunications

26.	**CALNET.** The state's telecommunication system is not breaking even and state agencies continue to buy services elsewhere.	H-70
27.	**Telecommunications Study.** Effectiveness of consultant study of the state's telecommunication situation dependent on contract which will allow unbiased assessment of potential solutions.	H-71
28.	**Public Safety Microwave Network (PSMN).** Recommend supplemental report language requiring a plan to convert the PSMN to digital technology.	H-72

Technology Initiatives

29.	**Selling Information Technology.** Recommend department explain its policy regarding separate programs which sell millions of dollars of information technology to state and other governmental agencies.	H-73
30.	**Videoconferencing.** State agencies invest in promising technology, but results are not widely known.	H-74
31.	**Electronic Commerce.** Efforts to reduce procurement costs through electronic commerce technology are stymied by state's information technology leadership situation.	H-75

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32.	**Getting Rid of Costly Paper Processes.** Department's effort to automate the State Administrative Manual should ultimately reduce state costs.	H-76

California State Police

33.	**State Police Proposed for Transfer.** The budget proposes to transfer responsibility for the State Police to the California Highway Patrol.	H-77

Public Employees Retirement System (PERS)

34.	**Report on Investment Performance.** Recommend that the PERS report to the fiscal committees prior to budget hearings on recent poor investment performance by the PERS trust fund. We further recommend that the PERS report on the reasons for a recent change in investment strategy and the potential under that strategy for increased fund volatility.	H-80

State Teachers' Retirement System (STRS)

35.	**State Contributions to Teachers' Retirement Fund.** General Fund contributions to the STRS total nearly $900 million in the budget year—an increase of almost $34 million.	H-84
36.	**Overview of STRS Investment Performance.** We recommend that the STRS report to the fiscal committees on recent poor investment performance by the STRS trust fund and prospects for the future.	H-85

Stephen P. Teale Data Center

37.	**Plan Needed to Reduce Mainframe Dependence.** Recommend supplemental report language requiring data centerto adopt plan to increase use of less costly computer solutions.	H-87
38.	**Duplicative Leave Accounting Systems.** Recommend Bud-	H-89

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	get Bill language requiring a plan to phase out a duplicative service.	
39.	**Too Many Managers.** Recommend data center advise the Legislature as to the status of efforts to reduce number of technical management classifications.	H-90
40.	**Legislative Direction Not Followed.** Recommend Budget Bill language requiring (a) an independent review of the data center's billing and cost recovery practices and (b) the establishment of a board of directors to oversee certain data center activities.	H-91
41.	**Notification to the Legislature of Certain Activities.** Recommend Budget Bill language restoring requirement for advance notification for certain activities which have fiscal implications.	H-92
42.	**Status of Contract With DMV for Network Services.** Recommend the data center advise the Legislature as to the status of efforts to amend contract to require DMV to pay the full cost of services received.	H-93
43.	**Uncertain Future for DMV Computer.** Withhold recommendation on $1.7 million budgeted in support of computer because the computer's future is uncertain.	H-93
44.	**Technical Overbudgeting Issues. Reduce Item 2780-001-683 by $5.4 Million.** Recommend reduction due to overbudgeting.	H-94
45.	**Performance Budgeting.** Data center is no longer participating in the performance budgeting pilot program.	H-94

Health and Welfare Agency Data Center

46.	**Statewide Automated Welfare System (SAWS) Needs Further Review.** Withhold recommendation on $20 million proposed to support the Department of Social Services' SAWS project, pending legislative review of the fiscal and policy issues concerning the project.	H-95
47.	**Funding for Kiosk Project Inconsistent With Legislative**	H-96

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	Direction. Reduce Item 4130-001-632 by $6.7 Million. Recommend deletion of funds for computer-based kiosk program because the Legislature has made its intent clear to eliminate all funding for the program in 1994-95.	
48.	**Dependence on Mainframe Computers.** Recommend supplemental report language directing the data center to adopt a plan to reduce dependence on costly computer mainframes.	H-97
49.	**Internet Support Not Justified. Reduce Item 4130-001-632 by $236,000.** Recommend deletion because the need for additional resources has not been justified.	H-98
50.	**Consolidation Study.** Administration fails to complete data center consolidation study.	H-98

Department of Personnel Administration (DPA)

51.	**Overview of DPA Budget.** The budget proposes additional funds for DPA programs, primarily from reimbursements from other state departments.	H-100
52.	**New Collective Bargaining Agreements Under Negotiation.** We recommend that the DPA report during budget hearings on the administration's collective bargaining proposals, the status of negotiations, and the format/nature of fiscal information to be provided to the Legislature with the completed bargaining agreements.	H-101

Board of Control

53.	**Shortfalls in Victims of Crime (VOC) Program.** Recommend that board report during budget hearings on status of funding for the VOC Program.	H-103

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Department of Finance

54. **Information Technology Oversight.** Withhold recommendation on $2 million proposed for support of Office of Information Technology, pending receipt and review of Governor's plan to create new Office of Chief Information Officer. H-109

55. **Performance Review Positions.** Withhold recommendation on $501,000 and seven positions pending clarification of proposal during budget hearings. H-110

Military Department

56. **National Guard Activities Along the Border. Reduce Item 8940-001-001 by $1.3 Million.** Recommend deletion of $1.3 million proposed for law enforcement along the border because activities are not a state responsibility. H-112

Department of Veterans Affairs

57. **Funding for New Barstow Veterans' Home Not Included in Budget.** The administration advises that it will submit the funding request later in the budget process. H-115

Health and Dental Benefits for Annuitants

58. **Budget-Year Costs Are Uncertain.** We withhold recommendation on the $295.7 million General Fund request for Health and Dental Benefits for Annuitants pending final determination of premium rates. H-117

Control Section 3.60

PERS Employer Contribution Rates

59. **Final Rates Not Yet Known.** We withhold recommendation on employer contribution rates for retirement benefits pending final determination of the actual rates to be applied in the budget year and receipt and review of informa- H-119

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tion regarding the basis for the actuarial assumptions underlying the determined rates.

Control Section 4.00

State Contribution Rates for Health Insurance Premiums

60. **State Contribution Rates.** We recommend that the Legislature set health insurance contribution rates for state employees based on either existing law or new collective bargaining MOUs ratified by the Legislature. Further, we withhold recommendation on those rates, pending final negotiations between the state and health insurers. H-120