

MAJOR ISSUES

General Government

- Performance of New Department of Information Technology (DOIT) Has Been Mixed**
 - Because the department was established in 1995, it is too early to determine conclusively how well the department is performing. However, its performance to date in meeting its statutory responsibilities has been mixed (See page G-66).

 - Approach to State Telecommunications Raises Questions**
 - The Department of General Services and the DOIT have proposed the divestiture of the state's telecommunications operations.
 - We raise several concerns about the administration's proposal. Given the dependence of state operations on telecommunications, it is essential that the proposal be on a sound footing (See page G-117).

 - Cost to Modify State Computer Programs For the Year 2000 Will Likely Be Substantial**
 - The state will face a significant challenge to modify its computer programs to accommodate the year 2000 change, because most programs were written to accommodate only years beginning with "19."
 - The DOIT has been providing guidance to departments faced with making the conversion (See page G-64).
 - The statewide costs of conversion are unknown, but will likely exceed \$50 million (See page G-145).
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Improvements in Performance of Office of Emergency Services (OES) Are Slow

- The ability of OES to carry out its disaster recovery and hazard mitigation responsibilities continues to be hampered by internal shortcomings.
- The Legislature should consider whether these functions ought to be transferred to another state agency (See page G-91).

Legislature Should Reconsider the COPS Program

- The COPS program is not an ideal structure for furthering state public safety objectives, or for providing local fiscal relief.
- We recommend that the Legislature use the proposed \$100 million (General Fund) of COPS funds to: (1) Augment spending for other state-local public safety programs and (2) provide general purpose fiscal relief to local governments (See page G-173).

Lottery Act Should Be Amended to Provide Legislative Oversight

- The Lottery Commission budget for administration of the lottery is over \$300 million annually. The commission spends these funds without external review by either the administration or the Legislature.
 - Recently, the commission's spending on administration has been about the statutory maximum of 16 percent of lottery revenues. If the commission spends less than 16 percent of revenues, the difference is available for education.
 - Given recent concerns about some of the commission's administrative expenditures and their impact on education funding, the Legislature should amend the Lottery Act to provide accountability through legislative and executive branch oversight. (See page G-27.)
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OVERVIEW

General Government

Funding for general government is proposed to increase slightly in the budget year, primarily because of increases in Motor Vehicle License Fund apportionments to local governments.

This section includes a variety of programs and departments with a wide range of responsibilities and functions. The purpose of state funding for these programs includes providing financial assistance to local governments, protecting consumers, promoting business development, providing services to state agencies, ensuring fair employment practices, and collecting revenues to fund state activities. The budget proposes total expenditures for general government of \$7.3 billion in 1997-98, an increase of \$202 million, or 2.8 percent, above estimated current-year expenditures. The bulk of the increase—\$124 million—is attributable to increases in Motor Vehicle License Fund apportionments to local governments.

SPENDING BY MAJOR PROGRAM

There are seven major program areas within general government:

- Shared revenues (state-collected revenues distributed to local governments).
 - Tax relief.
 - Local government financing.
 - Regulatory programs (including both consumer and business-related activities).
 - Tax collection programs.
 - State administrative functions.
 - State retirement and employment.
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We describe these program areas below.

Shared Revenues

The largest general government program is the shared revenues program, which distributes state-collected revenue (primarily from vehicle license fees and gas taxes) to local government agencies. The budget includes \$3.6 billion for shared revenues, an increase of \$148 million, or 4.3 percent, above the current-year amount. The increase in spending primarily results from an increase in the Motor Vehicle License Fund apportionments to local governments as a result of growth in the fee revenues collected.

Tax Relief

The state provides local property tax relief, both as subventions to local governments and as direct payments to eligible taxpayers, through seven different programs. The two largest are the Homeowners' Property Tax Relief (homeowners' exemption) and the Renters' Tax Relief (renters' credit) programs. The Governor's budget proposes an expenditure of \$405 million on the homeowners' exemption program in 1997-98, which comprises most of the \$476 million budgeted for tax relief.

The renters' credit provides a refundable tax credit to Californians who rent their principal place of residence as of March 1 each year. The renters' credit program was suspended from 1993 through 1996 as one of many spending reductions enacted to address the state's budgetary problems. The program was reinstated beginning on January 1, 1997. The Governor's budget, however, proposes eliminating this program effective January 1, 1997. The estimated cost of this program in 1997-98 if it were not altered or discontinued would be approximately \$525 million.

Local Government Financing

The Governor's budget proposes to subvne \$110 million (General Fund) to cities and counties. Almost all of this amount (\$100 million) would go for continuation of the Governor's COPS program enacted last year of funds available; \$75 million would be distributed to cities and counties for police and sheriffs' patrol services. The remainder would be allocated to district attorneys and jail services provided by sheriffs. (For a discussion of the COPS program, please see *The 1997-98 Budget: Perspectives and Issues*.)

Regulatory Activities

Consumer Activities. Several special fund agencies, including the Department of Consumer Affairs (DCA), Board of Chiropractic Examiners, the Board of Osteopathic Examiners, and the Office of Real Estate Appraisers, are responsible for promoting consumer protection by regulating more than two million practitioners in some 180 professions and businesses. The budget includes about \$309 million (\$303 million for DCA) for these consumer regulatory activities in 1997-98. This is \$7 million, or 2 percent, less than estimated current-year expenditures. This decrease is due mainly to the reduction of one-time costs in the current year for enforcement expenditures related to the reform of the cemetery industry.

Business Activities. Sixteen state agencies regulate various business activities, from health insurance to horse racing. The purpose of these agencies is to promote business development while regulating various aspects of business and employment practices. Chief among them are the Department of Industrial Relations, the Department of Food and Agriculture, and the Department of Insurance. Other regulatory bodies include the Horse Racing Board, the Department of Fair Employment and Housing, and the Energy Commission. The budget proposes about \$796 million for these activities in 1997-98. This is an increase of about \$25 million, or 3 percent, over estimated currently-year expenditures. The largest increase is an additional \$50 million for the Energy Commission.

Tax Collection Programs

Expenditures. The Franchise Tax Board (FTB) and the Board of Equalization (BOE) are the largest revenue collection agencies in the state. Together, both boards collect the state's personal and business income taxes, sales tax, and special use taxes. The budget proposes \$650 million for these tax programs in 1997-98. This is a net reduction of \$6 million (about 1 percent) from estimated current-year expenditures. This net decrease is the result of several large augmentations (such as merit salary increases and workload adjustments), offset by supervisor reductions at the BOE and reductions in one-time payments to computer system vendors.

Both FTB and BOE have initiated several large-scale information technology projects to automate various tax collection functions. While early results indicate improvements in revenue generation, some projects have experienced implementation delays and cost overruns.

Revenues. The estimated combined General Fund collections under both boards is projected to be almost \$50 billion in 1997-98. This is an

increase of nearly \$2 billion over estimated current-year revenues. Almost half of General Fund revenues (\$24 billion) comes from personal income taxes.

State Administrative Functions

There are more than 30 departments and agencies that provide a wide range of administrative services. These services range from oversight and support of other departments (such as the Department of General Services, the Department of Information Technology, and Office of Administrative Law), to economic development (such as the Trade and Commerce Agency), to various specialized services provided to individuals and communities (such as the Office of Emergency Services, Military Department, and Department of Veterans Affairs).

The budget proposes a total of \$930 million to support these functions in 1997-98. This is an increase of \$38 million, or 4.3 percent, above current-year expenditures. The budgets of most of the departments in this category are proposed to remain flat or increase only slightly in the budget year. The most significant budget-year increases are for the Department of General Services (\$9 million, or 6.6 percent), Board of Control (\$7 million, or 9.1 percent), and the California Science Center (formerly known as the Museum of Science and Industry—\$6 million, or 73 percent).

State Retirement Programs

Retirement-related expenditures account for a significant part of state spending for the budget year. In 1997-98, state expenditures for various costs associated with public employee retirement (excluding University of California costs and nongovernmental cost funds) will total approximately \$3.1 billion, including almost \$2.2 billion from the General Fund. As summarized in Figure 1, the General Fund provides for employer contributions and/or various other payments to four retirement systems. 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.

Public Employees' Retirement System. The Public Employees' Retirement System (PERS) is the retirement system for most state employees. The budget projects General Fund expenditures of \$588 million for PERS in 1997-98. This amount is based on the 1995-96 employee payroll, pursuant to Chapter 71, Statutes 1993 (SB 240, Committee on Budget and Fiscal Review). Under the provisions of that legislation, General Fund contributions are made two fiscal years in arrears. The PERS costs that state agen-

cies will incur in 1997-98—about \$680 million—will not show up as a General Fund payment until 1999-00.

Figure 1	
1997-98 General Fund Costs For Retirement Programs^a	
(In Millions)	
Program	1997-98
Public Employees' Retirement	\$588
State Teachers' Retirement	971
Judges' Retirement	61
Legislators' Retirement	1
Social Security and Medicare ^b	290
Health and Dental Benefits for Annuitants	279
Total	\$2,190

^a Excludes costs for University of California employees.
^b Legislative Analyst's Office estimate based on 1996 costs.

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 a deferred, basis. The state has appealed this decision and the budget assumes that the state will prevail on the appeal. If the state loses the appeal, the General Fund impact would be about *\$1.1 billion* in 1997-98.

State Teachers' Retirement System. The State Teachers' Retirement System (STRS) is the retirement system for teachers in public K-12 schools and community colleges. The STRS receives contributions from teachers and their employers. These contributions, however, are insufficient to provide for the cost of basic retirement benefits and the protection of retirees' purchasing power. These shortfalls are covered by annual transfers from the General Fund. These transfers are expected to increase by \$39 million, from \$883 million in the current year to \$932 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 \$279 million from the General Fund to pay the state share of health and dental insurance premiums for retired state employees and their qualifying beneficia-

ries. This is \$10.7 million more than estimated current-year expenditures, which reflects an increase in the number of retirees. The PERS is currently negotiating the health and dental premiums rates for the second half of the budget year. These negotiations may result in a change in the estimated General Fund cost for the budget year.

Employee Compensation

The collective bargaining memoranda of understanding (MOU) that govern pay, benefits, and other working conditions for over 150,000 rank-and-file state employees (other than higher education) expired June 30, 1995. Since then, the MOU negotiations have been completed for only one of the 21 bargaining unit—the highway patrol officers. This MOU, however, expires on June 30, 1997. The budget does not include funds for new compensation increases for any state employees (other than higher education).

CROSSCUTTING ISSUES

General Government

THE STATE'S AUDIT PROGRAMS

We recommend that the Legislature not approve \$18.9 million and 145 positions for the Board of Equalization (BOE) and Franchise Tax Board (FTB) that are requested, for the most part, on the basis of potential revenue benefits or losses because the Legislature does not have sufficient information to review the validity of the methodology used by BOE and FTB to make revenue impact calculations. We further recommend that BOE and FTB submit a report to the Legislature, evaluating the revenue impact of previous audit program augmentations.

As summarized in Figure 2, the budget proposes several augmentations—totaling \$18.9 million (\$16.8 million General Fund) and 145 positions—for Board of Equalization (BOE) and Franchise Tax Board (FTB). Although none of these requests are directly related to the boards' audit programs, both boards justify the augmentations on the basis that there will be a potential negative revenue impact due to foregone audit activity—to the tune of \$128 million—if these requests are disallowed.

While some or all of the augmentations may have merit on a workload basis, we have several concerns about the boards justifying expansion of non-audit related programs on the basis of revenue impact. Furthermore, we believe the Legislature needs more information on the effectiveness of the boards' audit programs before it can evaluate the budget-year (and any future) augmentation requests. Specifically, the Legislature needs more information on the cost of generating *and* collecting revenues for the state before it can determine that there is a direct revenue benefit to each proposed non-audit related augmentation. We would note that both boards have been responsive to our initial requests for audit program

information and have indicated that they are prepared to respond to additional legislative inquiries.

Figure 2			
Augmentation Requests Justified on a Revenue Basis 1997-98			
(Dollars in Thousands)			
	Expenditures Requested	Positions Requested	Claimed Revenue Loss^a
Board of Equalization			
Budget Change Proposals (Item 0860-001-0001)			
Merit salary adjustments	\$3,300	—	\$16,300
Settlement Program workload growth	670	12	\$3,350
Cigarette and Tobacco Tax Enforcement Program workload growth	772	9	\$4,600
Subtotals	(\$4,742)	(21)	(\$24,250)
Franchise Tax Board			
Budget Change Proposals (Item 1730-001-0001)			
Merit salary adjustments	\$7,000	—	\$65,300
Settlement Program workload growth	1,900	26	\$12,200
Return processing workload growth	5,300	98	\$26,300
Subtotals	(\$14,200)	(124)	\$103,800
Totals	\$18,942	145	\$128,050

^a If change not funded.

BACKGROUND

Resources Dedicated to the Audit Function

California's two major tax agencies—BOE and FTB—expect to spend about \$490 million from the General Fund in 1997-98 to collect \$47 billion in General Fund revenues from the state's three major taxes—the Personal Income Tax, the Sales and Use Tax, and the Bank and Corporation Tax. Of the \$490 million total, approximately \$300 million will be spent on audit activities and about \$90 million on collection activities.

In recent years, both boards have justified most augmentation requests—whether they were for new tax programs, workload adjustments to existing programs, salary and operating expense increases (such as merit salary adjustments and the purchase of modular furniture and information technology), or so-called revenue enhancement programs—on the basis of revenue impact. As mentioned above, we have several questions about the validity of this justification and the following discussion raises some issues we believe the Legislature should be aware of when evaluating augmentation requests for the BOE and FTB.

Auditors Added. Since 1992-93, the Legislature has added, at a cost of \$18.3 million, a total of 440 permanent auditor positions to both boards. Figure 3 shows the number of auditors added to each board by fiscal year. In addition to these auditor positions, clerical and paraprofessional staff have been added to both boards as audit support positions.

These augmentations increased BOE and FTB audit staff by 25 percent and 56 percent, respectively, over 1991-92 levels. The Legislature approved these additional auditors on the premise that there would be at least a 5 to 1 benefit/cost ratio (rate of return) for tax auditing activity (a \$5 incremental gain in tax revenue for every \$1 spent on direct audit costs).

Figure 3

Changes in Auditor Positions 1992-93 Through 1996-97

	1992-93	1993-94	1994-95	1995-96	1996-97	Total
Board of Equalization	256	79	-60 ^a	26	-28 ^a	273
Franchise Tax Board	50	24	76	16	1	167
Totals	306	103	16	42	-27	440

^a Expiration of limited-term positions added in 1992-93 and 1993-94.

BOE and FTB Audit Programs

The state's audit programs are designed to identify, on a priority basis, taxpayers who have not reported or have under-reported taxable income. Both boards conduct targeted audits as new areas of noncompliance are identified. Based on board priorities for tax compliance, certain accounts receive 100 percent audit coverage over the three-year audit cycle, while other types of accounts can receive, less than 2 percent coverage over the audit cycle. The boards have a total of over 1,800 auditor positions autho-

rized for the current year—1,351 for BOE and 466 for FTB—representing about one-fifth of the combined total staffing levels of both boards. Together, both boards plan to conduct over 800,000 audits in the current year.

In general, there are two types of audit workloads—desk audits and the more expensive field audits. Desk audits generally can be conducted by clerical or paraprofessional staff through telephone and written correspondence from board headquarters. According to FTB, 99.5 percent of its audits are desk audits. Information on the distribution of BOE audit workload by type was not available at the time this analysis was written.

Field audits usually require district office auditors to audit on site. In support of their field audit programs, both boards maintain several field offices (16 offices for FTB and 27 offices for BOE). In addition, both boards maintain out-of-state field offices in the New York, Chicago, and Houston areas, with a total of 316 staff (141 positions in FTB's four offices and 175 positions in BOE's three offices) for auditing of multistate accounts.

CONCERNS ABOUT AUDIT PROGRAM AND BUDGET REQUESTS

In evaluating the state's audit programs and the budget-year augmentation requests for BOE and FTB, we believe there are several issues the Legislature should consider. They include:

- Information on the total direct *and* indirect costs of generating and collecting additional revenues for the state.
- The current value of revenues identified through audit.
- Opportunities for efficiency improvements in lieu of augmentations.
- The appropriate level of auditing taxpayers.

Other Costs Reduce Claimed Rate of Return

In addition to the direct costs of audit activities, such as auditor salaries and field office operating expenses, there are several other indirect program and administrative costs associated with conducting audits. For example, both boards devote significant resources to the related audit support functions of:

- Overhead expenses (such as taxpayer information services and call centers, taxpayer protest settlements and hearings, and administrative support).
- Collections operations.
- Information technology projects.

As discussed below, these costs are not always included in the calculation of the benefit to cost ratio.

Overhead Expenses. According to both boards, the workload associated with taxpayer inquiries, protests, settlements, appeals, litigation, and delinquent collections has increased in proportion to the number of audits conducted. For example, both boards report a significant increase in the volume of (1) calls coming into their toll-free (800 number) telephone lines and (2) audit protests and appeals. As a result, the actual costs of collecting additional revenue continue to increase. (When a taxpayer chooses to appeal an audit decision, the boards can take one of two actions—settle the dispute through the state’s tax dispute settlement program or proceed with formal protest and appeals hearings.) For example, both BOE and FTB have submitted requests totaling \$2.6 million for 38 additional positions in the budget year to handle settlement program workload growth. It is unclear which of the above overhead expenses, if any, are included in the benefit/cost ratio.

Collection Operations. Collection activities, which usually involve filing liens on wage and bank accounts, are another cost component of the total effort by both boards to generate revenue for the state. In general, both boards are able to use automated processes to initiate collection activities against delinquent accounts. A small portion of delinquent accounts (less than 5 percent) are contracted to private vendors for collection. In our view, the full cost of any activity related to collecting tax amounts identified through audit should be considered as part of the overall *and true* cost of generating revenue for the state.

With regard to collection costs, the BOE has indicated that, due to deficiencies in its information management systems, it cannot identify (1) the costs of collecting additional revenues identified through audit or (2) the amount of revenue collected through audit findings. The FTB also indicated that it does not track actual revenue collected due to audit activity. Thus, currently, it is not possible for the Legislature to know what the *true* rate of return is on audit activity.

Information Technology Projects. These are another example of direct and indirect costs that may not be fully included in the boards’ rate of return calculations. In an attempt to automate various tax auditing and

collection functions and reduce program costs, both boards have initiated several large-scale information technology projects—totaling at least \$150 million. While early results indicate increased revenue generation from improved audit modeling programs and taxpayer information databases, some projects have experienced implementation delays and cost overruns. For example, projected revenue generation has not been realized as estimated because the largest projects at both the BOE and FTB—the Integrated Revenue Information System and the Bank and Corporation System Redesign—are behind schedule. It is not clear that BOE and FTB include those information technology implementation costs in the audit rate of return.

Conclusion. Our review of the BOE and FTB audit programs indicates that these cost elements (whether considered separately or in total) reduce the state's return on audit programs. For example, BOE indicates that the 1995-96 benefit/cost ratio for its sales and use tax program decreases from \$5.45 to \$3.80 when indirect costs related to taxpayer protests and administrative support are taken into consideration. More importantly, the \$3.80 does *not* include collection costs. Consequently, we believe the 5 to 1 benefit/cost ratio overstates the true rate of return on state audit activity.

Total Revenues Should Be Discounted

The rate of return on audit activity also may be overstated because actual revenue collections lag behind audit activity by several years. That is, audit *costs* are incurred “up front,” but the audit *revenues* come in over a period of years. To get a true rate of return for audit activity, the revenue to be collected should be discounted for the time it takes the boards to collect the monies due. Doing so has the effect of reducing the benefit/cost ratio by about 20 percent.

Opportunities for Efficiencies In Lieu of Audit Augmentation

As mentioned above, both BOE and FTB frequently claim that any reduction in their budgets will lead to a corresponding five-fold revenue loss. For example, as Figure 1 shows, the FTB is requesting \$5.3 million and 98 positions for workload growth related to processing tax returns. The FTB justifies the need for this augmentation, in part, by stating that if the request is denied the board will redirect existing resources to this activity and there will be a revenue loss of \$26.3 million. The underlying assumptions in this argument are that: (1) in lieu of reducing operating expenses and redirecting savings realized from efficiency improvements (such as automation), the board will be forced to redirect from audit

activity and (2) all audit activity will, on average, produce \$5 in revenue for every \$1 spent.

As discussed above, we have several concerns about the validity of this claim because, here too, neither full indirect costs of audit nor direct costs of actual revenue *collection* from audit are considered in this calculation. Furthermore, the boards should be able to manage their operations in a more efficient manner in order to redirect costs in ways that do *not* affect revenues. For example, the BOE—on its own initiative—is reducing its baseline budget by \$1.6 million and 32 positions in the budget year without identifying any projected revenue loss. In addition, the past automation efforts of both boards should improve operations and reduce costs.

Audit Presence

In approving resources for the state's audit programs, the Legislature needs to consider issues in addition to the revenue return on audit activities. For example:

- ***The Appropriate Level of Taxpayer Compliance.*** One of the main purposes of auditing—irrespective of the fiscal benefit to the state—is to ensure that all taxpayers are reporting and paying their legal obligations. In considering audit requests, the Legislature has to determine the appropriate level of “equity” it wants in taxpayer compliance.
- ***Harassment Issue.*** The Legislature also has to consider the possible consequences of audit presence. Taxpayers can feel they are being harassed by the state.

Balancing taxpayers' desire for equity with their equally strong opposition to perceived harassment by tax agencies is an ongoing challenge for the Legislature and the boards.

LEGISLATURE NEEDS MORE INFORMATION

Based on the issues discussed above and our concerns that BOE and FTB are overstating the 5 to 1 rate of return on audit programs, we recommend that the Legislature receive and review additional information on the state's audit programs. To ensure that the Legislature has the information it needs to: (1) evaluate the effectiveness of the state's audit programs and (2) determine if the 5 to 1 methodology is valid, we recommend that BOE and FTB be required to submit a report by November 1, 1997, on the audit programs. We recommend, therefore, that the Legislature adopt the following supplemental report language:

The Board of Equalization and the Franchise Tax Board shall each provide the Legislature a report by November 1, 1997, on their audit programs. Each report shall, at a minimum, identify by fiscal year since 1992-93 (1) authorized, filled, and vacant auditor positions, (2) the classification of all authorized, filled, and vacant auditor position, (3) the number of supervisory auditor positions, (3) the approved and filled program assignment of all authorized auditor positions, (4) the revenue identified *and collected* through the audit activities of the filled auditor positions by types of audit, and (5) the total costs— direct and indirect— of identifying *and collecting* these revenues through audit.

This information will give the Legislature the opportunity to evaluate the impact of the 440 auditor positions added to both boards since 1992-93. Until the Legislature has a better understanding of the true revenue generating capabilities of the state's audit programs, it cannot accurately evaluate augmentation requests that are justified on the basis of a 5 to 1 revenue impact.

Therefore, we recommend that the Legislature delete \$18.9 million and 145 positions included in the budget for the boards as shown in Figure 1. As mentioned above, some or all of the requests may have merit. Therefore, if the boards can provide additional information that demonstrates that the augmentations are justified on a workload basis, legislative consideration of the proposed augmentations or other adjustments to their respective budgets may be warranted. (Reduce Item 0860-001-0001 by \$4,742,000 and 21 positions; reduce Item 1730-001-0001 by \$18,942,000 and 124 positions.



OVERVIEW OF EMPLOYEE COMPENSATION ISSUES

A major portion of state government expenditures is for compensation of state employees. The Governor's budget projects \$12.4 billion for salary and wage expenditures for nearly 278,000 authorized personnel-years in 1997-98 (including \$4.1 billion and 89,300 personnel-years in higher education). Including benefits (such as contributions to retirement and health insurance), estimated employee compensation expenditures exceed \$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 (except for higher education).
- Collective bargaining agreements may again not be settled by the beginning of the budget year.
- Legislative oversight of state employee collective bargaining agreements.

EMPLOYEE PAY/BENEFIT INCREASES

State employees (other than those in higher education) last received a general pay increase (3 percent) on January 1, 1995. The budget does not propose funds for new pay or benefit increases for these employees. In higher education, the Governor proposes a 4 percent increase to the baseline budgets of the University of California and the California State University (in keeping with the terms of the Governor's four-year "compact") but leaves it to the systems to allocate these funds among compensation and other purposes. Out of this increase, the systems propose to spend \$155 million for salary and benefit increases. Figure 4 (see page 20) shows how this amount will be allocated.

Figure 4	
Higher Education Salary and Benefit Increases 1997-98 Governor's Budget General Fund	
(In Millions)	
University of California	
5 percent faculty salary increase, effective 10/1/97	\$28.1
2 percent staff cost-of-living increase, effective 10/1/97	19.5
Full-year cost of 1996-97 salary increases	15.2
Merit salary adjustments	34.1
Subtotal	(\$96.9)
California State University	
Salary and benefit increases to be negotiated	\$55.0
Full-year cost of 1996-97 salary/benefit increases	2.8
Subtotal	(\$57.8)
Higher Education Total	\$154.7

New Collective Bargaining Agreements Still Under Negotiation

The Department of Personnel Administration should report to the budget committees during budget hearings on the administration's collective bargaining proposals and the status of negotiations.

The Department of Personnel Administration (DPA) began negotiations in 1995 with the 21 bargaining units representing rank-and-file state employees (other than higher education) for new Memoranda of Understandings (MOUs) governing compensation and other terms and conditions of employment. These MOUs are to replace MOUs that expired June 30, 1995. In 1995, the DPA reached agreement with only one of the 21 units, the highway patrol officers. This MOU expires, however, on June 30, 1997.

Under current law, the provisions of expired MOUs generally remain in effect pending adoption of replacement MOUs. Thus, unless the DPA can negotiate successfully with one or more of the 21 bargaining units

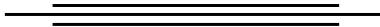
before June 30, 1997, the state will begin another budget year with expired MOUs. In our analysis of the DPA budget, we recommend that the DPA report to the budget committees during budget hearings on the administration's collective bargaining proposals and the status of negotiations.

Strengthen Legislature's Collective Bargaining Oversight

We continue to recommend that the Legislature adopt policies to assure that the Legislature will have the opportunity to fully review proposed collective bargaining agreements.

In our overview of employee compensation issues in the *Analysis of the 1995-96 Budget Bill*, we discussed at some length the need to strengthen the Legislature's oversight of proposed collective bargaining agreements. In order to assure the Legislature has the opportunity to appropriately review new MOUs, we continue to 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 annual 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 the 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 ensure 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.



DEPARTMENTAL ISSUES

General Government

DEPARTMENT OF INSURANCE (0845)

Insurance is the only interstate business that is regulated entirely by the states, rather than the federal government. In California, the Department of Insurance is responsible for regulating insurance companies, brokers, and agents in order to protect businesses and individuals who purchase insurance. Currently, there are about 1,500 insurers and 264,000 brokers and agents operating in the state.

The budget proposes total expenditures of \$112.3 million—\$91.1 million state operations and \$21.2 million local assistance—to support the department in 1997-98. This is \$16.3 million, or 13 percent, less than estimated current-year expenditures.

According to the Governor's budget, this decrease has occurred in three program areas—a \$10.6 million reduction in the regulation of insurance companies and insurance producers, mainly in rate regulation and special programs (state operations); a \$2 million reduction in fraud control (local assistance); and a \$3.7 million reduction in earthquake recovery fund management (local assistance). As discussed below, however, the estimated expenditures for state operations in the current year vary substantially from the amount appropriated by the Legislature in the *1996-97 Budget Act* and there is no explanation in the Governor's budget or from the department regarding the proposed reduced expenditures in the budget year.

No Information on Department's Budget Changes

We recommend that the Legislature not approve the Department of Insurance budget until the department explains (1) current-year inconsistencies in the expenditure of funds appropriated by the Legislature and the programmatic implications of these actions and (2) changes in the department's budget for 1997-98 for which the department has provided no information on the basis for the reductions or the programmatic effect of the proposals.

Current Year Inconsistencies With Legislative Appropriations. The 1996-97 Budget Act included \$94.3 million for the general operations (excluding payments on lawsuit settlements) of the Department of Insurance. This amount was scheduled in the budget act for various program areas under the department. According to information from the department, the *total* estimated expenditures in the current year are the same as the budgeted amount but there are significant changes in expenditures *by program area*. Figure 5 compares the budget act schedule for expenditures to the department's planned expenditures.

Figure 5

Department of Insurance 1996-97 Expenditures Budget Authorization Compared to Planned Expenditures

(In Thousands)

Scheduled Program	1996-97 Budget Act	Department Expenditure Plan	Difference from Budget Act Authorization
Regulation of Insurance Companies and Insurance Producers	\$70,792 ^a	\$72,965	\$2,174
Fraud Control	20,554	20,021	-533
Tax collection and audit	1,641	—	-1,641
Administration	19,846	20,259	413
Distributed Administration	-19,846	-20,259	-412
Reimbursements	-710	-710	—
Totals	\$92,276	\$92,276	—

^a Includes \$623,000 from Item 0845-002-0217.

The Governor's budget includes only a summary statement indicating that changes in the current year include consolidation of office space, reduced fees paid to the Attorney General, reduction in travel, and elimination of vacant positions (the budget indicates elimination of 89 positions but does not indicate the number that were vacant). According to the Governor's budget, these actions resulted in a \$4.5 million reduction

in the department's budget. The administration, however, has not advised the Legislature of the specific revisions in the proposed expenditures or the programmatic implications of these changes. Furthermore, the changes as shown in Figure 5, are not allowed under Control Section 26.00 of the *1996-97 Budget Act* without first notifying the Legislature. This control section specifies limits on intraschedule transfers and requires notification to the Legislature for any transfers over \$200,000. We are not aware of any such notification to the Legislature. Consequently, it is not clear what authority the department used to modify its current year budget.

In view of the administrative actions discussed above, the department should provide the Legislature complete details of the proposed changes, the programmatic implications of each change, and the authority they used to make these budget changes in the current year. In addition, the Legislature included language in the *1996-97 Budget Act* indicating legislative intent that insofar as possible budget reductions were not to disproportionately affect the provisions of consumer services by the department. Therefore, the department should also address how all budget changes affected consumers services. This information should be available before the Legislature considers the budget-year request.

Proposed Changes in Budget Year Unexplained. The Governor's budget proposes a reduction of \$2.1 million in the department's ongoing regulatory program, sustains the elimination of the tax collection and audit program, and provides increases of about \$50,000 each in fraud and administration. The budget also reflects elimination of the 89 positions that were administratively eliminated in the current year. Unlike other departments, the Department of Insurance has not submitted budget change proposals describing the need for or effect of these changes, nor does the Governor's budget document describe any changes to the program. Consequently, the Legislature does not have any information to assess the effects of the department's proposed 1997-98 budget. We recommend that the Legislature not approve the department's budget request until this information is available for review.

Summary. In summary, the Department of Insurance has revised its budget and program in the current year without advising the Legislature in accordance with requirements in the budget act. In addition, the budget proposed for 1997-98 includes budget changes that have not been identified for legislative consideration. We recommend that the Legislature not approve the department's budget until complete information on the department's changes in the current year and budget year are available for legislative review.

CALIFORNIA STATE LOTTERY COMMISSION (0850)

The California State Lottery (CSL) was created by the Lottery Act, an initiative statutory and constitutional amendment approved by the voters in 1984. The CSL began operations in October 1985. Revenues from lottery sales are deposited in the State Lottery Fund and are continuously appropriated to the California State Lottery Commission by Section 8880.61 of the Government Code. A brief outline of the commission's 1997-98 preliminary budget is displayed in the Governor's budget for informational purposes only. The budget is not contained in the *1997-98 Budget Bill*.

The act provides that lottery proceeds are to be distributed annually as follows: 50 percent of lottery revenue returned to the public in the form of winnings, at least 34 percent made available for public education, and no more than 16 percent for administrative costs. Figure 6 shows the distribution of these funds since 1985-86. It shows that lottery revenues reached a high of \$2.6 billion in 1988-89 and a low of about \$1.4 billion in 1991-92. The commission estimates annual revenues of \$2 billion in the current and budget years, a decrease of about 13 percent from 1995-96.

The current-year decline in lottery revenues is due to the loss of two products—the on-line game of Keno and instant ticket (Scratchers) vending machines. Both these products were found to be illegal under state law, and the lottery removed them from play in summer 1996. Despite the use of a new game—Hot Spot—as a replacement for Keno, the combined loss of Keno and vending machine sales caused a \$207 million decrease in 1996-97 revenues through December 1996, a drop of 15 percent from the same prior period.

The budget shows estimated current- and budget-year administrative expenses, including game costs and retailer commissions, of \$320 million each year. This amount is right at the 16 percent maximum level of estimated annual revenues. This is \$33 million (9.3 percent) less than 1995-96 administrative expenditures. Education's share of lottery sales revenues since 1985-86 has varied from 33 percent to 35 percent.

Figure 6**Distribution of Lottery Revenue****(In Millions)**

Year	Administration	Education^a	Winning Payouts	Totals^b
1985-86	\$203	\$617	\$886	\$1,766
1986-87	209	490	693	1,392
1987-88	277	784	1,046	2,107
1988-89	323	992	1,314	2,628
1989-90	339	900	1,240	2,479
1990-91	323	747	1,062	2,132
1991-92	238	451	669	1,358
1992-93	281	597	880	1,758
1993-94	304	663	964	1,931
1994-95	336	755	1,075	2,166
1995-96	353	811	1,128	2,292
1996-97 ^c	320	680	1,000	2,000
1997-98 ^c	320	680	1,000	2,000

^a Amounts do not reflect distribution of unclaimed prizes or interest to education. According to the Lottery Act, these items are not considered as part of the 34 percent that is required to be allocated to the benefit of public education.

^b Estimated sales revenues only (does not include interest income).

^c Estimate.

AMEND THE LOTTERY ACT TO ESTABLISH LEGISLATIVE OVERSIGHT

We recommend that the Legislature amend the Lottery Act to provide for legislative oversight and appropriation of the California State Lottery Commission's administrative expenses.

The Lottery Act provides the commission certain flexibilities not normally granted to state agencies, such as the continuous appropriation of lottery funds for administrative expenses without external review and the right to establish its own procurement policies. Specifically, under provisions of Section 8880.61 of the Government Code, funding for the commission's support budget is exempt from the annual budget review process. In lieu of the regular legislative budgetary review, the five-member commission (which currently has two vacancies) approves all funding decisions. This budget independence has allowed the commission to

spend an average of about \$300 million annually on administration without oversight by the Legislature or the administration.

Administrative Budget. Figure 7 shows the CSL's administrative expenses and staffing levels since 1985-86. The figure shows that the CSL has spent from 11.5 percent to 17.5 percent of sales revenues on administrative expenses during the Lottery's 11-year operating history. The figure also shows that staffing has varied from a high of 1,244 positions down to the current level of 855 positions. Because the lottery budget is not submitted for review, it is not possible to know if these lottery administrative expenditures are consistent with the act's objective of maximizing education's share of sales revenues.

Figure 7								
Lottery Operating Budget								
(Dollars in Millions)								
	Salaries	Other ^a	Advertising	Game Costs	Retailer Commissions	Totals	Percentage of Sales	Positions
1985-86	\$20	\$25	\$24	\$44	\$90	\$203	11.5%	— ^b
1986-87	31	44	39	24	70	209	15.0	1,091
1987-88	37	55	54	25	105	277	13.1	1,138
1988-89	41	59	60	27	135	323	12.3	1,162
1989-90	45	68	73	23	130	339	13.7	1,244
1990-91	46	73	61	23	121	323	15.1	1,190
1991-92	43	38	41	35	81	238	17.5	1,007
1992-93	40	49	48	40	105	281	16.0	926
1993-94	43	52	42	51	115	304	15.7	920
1994-95	44	43	47	64	141	336	15.5	880
1995-96	47	43	44	71	148	353	15.4	894
1996-97 ^c	44	35	42	68	131	320	16.0	855
1997-98 ^c	44	35	42	68	131	320	16.0	855

^a Includes contracted and professional services.
^b Not available.
^c Estimate.

The total level of annual spending (close to \$300 million) for administration of the lottery and the impact that any overspending has on the amount allocated to education warrants legislative oversight of the commission's budget. An example of the potential impact on education is the year (1991-92) the commission overspent its 16 percent limit by 1.5 percent. This overspending resulted in a loss of \$20 million for education.

Procurement Contracts. Currently, the commission can also enter into and amend costly information technology contracts without any independent oversight. For example, in 1995-96 the commission terminated and subsequently reinstated a contract with High Integrity Systems, Inc. for an automated instant ticket gaming system. The contract was reinstated after both parties sued one another. The cost to litigate and settle the case was \$7.2 million, which represents money that otherwise could have gone to education. Furthermore, the commission has entered into several other contracts—one for as much as \$244 million—and continuously amended contracts, in one case up to 121 percent of the original contract amount, without any external review.

More recently (January 1997), the commission chose to extend, at an estimated cost of \$170 million, an existing \$203 million contract with G-TECH Corporation for operation of the lottery on-line gaming system. If this and other information technology contracts have not been handled effectively, funding for schools has been adversely affected. For example, the existing on-line gaming system contract was scheduled to expire in 1998, leaving the commission sufficient time to take the project out to bid. In fact, the lottery had begun soliciting bids but abruptly halted the competitive process once the commission chose, without any significant external oversight, to accept the unsolicited G-TECH extension offer. Because the lottery never completed the competitive bid process, it is impossible to determine if extending the G-TECH contract was cost effective. In our view, this latest decision further substantiates the need for legislative oversight of the commission's activities.

Establish Legislative Oversight. Given the magnitude of the commission's administrative expenditures and their impact on education funding, we continue to believe that it is important to establish legislative oversight of the Lottery's operations. Such external oversight could help improve the efficiency and effectiveness of the lottery's administrative activities. Consequently, we recommend that the Legislature amend the Lottery Act to provide for accountability through legislative and executive branch oversight. The Lottery Act can be amended with a two-thirds vote of the Legislature, provided that the changes are to further the act's purpose. Specifically, we recommend that the Legislature amend the Lottery Act to (1) require legislative appropriation in the budget act for the CSL's administrative expenditures within the 16 percent spending limit, effective for the 1997-98 fiscal year and (2) require CSL, like other state agencies, to prepare and submit information technology project planning documents and contracts to the administration for review. We believe that these amendments would be consistent with the intent of the act.

BUDGET SHOULD BE SUBMITTED FOR LEGISLATURE'S REVIEW

We recommend that the Legislature hold hearings on the commission's proposed 1997-98 budget and add an informational item to the budget bill, identifying the planned budget-year administrative expenditures, similar to the informational item for the Public Employees' Retirement System.

Governor Vetoes Legislative Oversight. In our 1996-97 *Analysis of the Budget Bill* (see page G-15), we recommended that the Legislature add an informational item displaying the lottery's budget in the 1996-97 *Budget Act* and adopt budget act language requiring the lottery budget to appear as an informational item in the annual budget bill. The Legislature adopted our recommendation, but the Governor vetoed both the informational item and language. The only action taken by the administration was the signing of a memorandum of understanding (MOU) between the commission and the Department of Information Technology (DOIT) for DOIT to assist the commission with future information technology contracts. The DOIT's role, however, is purely advisory and the MOU does not provide for administration approval of information technology contracts as is required for other state agencies. Furthermore, our review indicates that DOIT did not play a significant role in the recent extension of the G-TECH contract. Thus, the commission continues to operate without any meaningful external oversight.

We again recommend that the Legislature hold hearings on the commission's proposed 1997-98 budget and add an informational item to the budget bill identifying planned budget-year expenditures for administration, similar to the informational item for the Public Employees' Retirement System. With this action, the Legislature will have some degree of oversight on the lottery in the budget year. In order for the Legislature to take this action, the commission should submit budget information concerning planned expenditures and staffing in the budget year. The commission should send this information to the Legislature in advance of budget hearings to allow sufficient time for legislative review.



DEPARTMENT OF CONSUMER AFFAIRS (1110-1600)

The Department of Consumer Affairs (DCA) is responsible for promoting consumer protection while supporting a fair and competitive marketplace. The department includes 30 regulatory boards, seven bureaus, and two programs that license and regulate over 2 million practitioners from various occupations and professions. The seven bureaus and two programs are statutorily under the direct control of the department. The regulatory boards are independent and administered by appointed consumer and industry representatives.

Expenditures for the support of the department and its constituent boards are expected to total \$303 million in 1997-98. This is \$6.9 million, or 7 percent, less than estimated expenditures in the current year. This decrease is due mainly to the end of \$6.4 million in one-time costs in the current year, supported by special fund loans (Contractors' License Fund and Tax Preparers Fund), for enforcement workload related to the Cemetery Act.

LEGISLATURE MAKES CHANGES IN BOARDS AND PROGRAMS

The Legislature made several changes to DCA boards and programs during the past legislative session. Chapter 1137, Statutes of 1996 (SB 1077, Greene) eliminates the Tax Preparer Program effective July 1, 1997 and transfers all remaining program assets (\$370,000) to the Cemetery Fund. In addition, Chapter 381, Statutes of 1995 (AB 910, Speier) transferred all duties and responsibilities of the Cemetery Board and the Board of Funeral Directors and Embalmers to the Director on January 1, 1996. This action was taken due to the Legislature's long-standing concerns over the activities of these two boards. The Cemetery Board delegated its responsibilities to the department through a memorandum of understanding in October 1995.

Three Boards Reorganized as Bureaus. Legislation enacted in 1994 (Chapter 908, Statutes of 1994, [SB 2036, McCorquodale]) put in place a procedure and schedule for the Legislature to assess the effectiveness of and need for state involvement in the 32 areas regulated by various boards. Through this sunset review process, legislative action to date is to allow the statutes that authorize the Board of Barbering and Cosmetology, Board of Guide Dogs for the Blind, and Board of Landscape Architects to sunset on July 1, 1997. As a consequence, the regulatory authorities and resources of these boards will become bureaus under the direct control of the department effective July 1, 1997.

CLEANUP OF CEMETERY INDUSTRY CONTINUES

The department continues to cleanup the cemetery industry and is requesting permanent funding for ongoing regulation of the industry. The department's request appears reasonable but we have concerns about the department's ability to fund the proposed level of activity. We recommend that the department report at budget hearings (1) on its plan to ensure adequate funding for proposed enforcement activities and (2) under what authority it has extended its loan repayment schedule.

Background. As mentioned above, all the duties and responsibilities of the Cemetery Board were assumed by the department in October 1995. Since that time, the department has been investigating charges of embezzlement, fraud, and mishandling of human remains. The base appropriations of the board (about \$400,000 and four positions) were transferred to the department.

Current-Year Efforts. The 1996-97 Budget Act and Chapter 38, Statutes of 1996 (AB 597, Speier) authorized \$6.4 million in one-time funding—financed from loans from the Contractors' License Fund (two loans) and the Tax Preparers Fund—in 1995-96 and the current year for the department to pay for cleanup of the cemetery industry. With this funding, the department initiated criminal investigations in southern California and took over financial management of ten cemeteries under state conservatorship. These loans are to be repaid over three years, with the first payment to be made in the budget year. Chapter 964, Statutes of 1996 (AB 2234, W. Murray), increased interment and cremation fees to pay for these activities and to repay the loans. The fees are scheduled to return to their original levels once the loans are repaid (but no later than April 1, 2003).

The department was scheduled to release a report by January 31, 1997 detailing the results of these enforcement efforts, including the number of investigations completed and criminal suits brought against licensees.

Proposed Ongoing Activities. The department is requesting \$880,000 as an annual baseline budget level—more than double the board’s historical annual budget—to complete enforcement actions initiated in the current year and for ongoing and routine regulation of the industry. Specifically, the budget proposes, among other permanent program elements, the following enforcement staff and activities:

- Three investigative certified public accountants to conduct routine financial audits on each regulated business once every five years (about 13 audits each year per auditor) and special audits as needed (\$175,000 and three positions).
- Two inspectors to conduct annual on-site inspections of the 323 privately owned cemeteries and crematoriums regulated by the state (\$74,000 and two positions).
- Two investigators (sworn peace officers) to conduct law enforcement-related investigative activities as needed (\$94,000 and 1.6 positions).
- One manager and one office technician to oversee the ten cemeteries under state conservatorship (\$110,000 and two positions).

Funding Concerns. In general, the department’s proposed level of regulation appears reasonable. We have several concerns, however, about the department’s ability to provide funding for these activities. For example, the department’s fund condition analysis indicates that by 2001-02 the reserve in the Cemetery Fund will equal approximately one week of program operating expenses. In general, regulatory agencies should maintain a prudent reserve of about three months funding. Furthermore, despite the *1996-97 Budget Act* requirement that the department repay the second Contractors’ License Fund loan over three years (beginning in the budget year) and the Chapter 38 requirement that the first Contractors’ License Fund loan be repaid no later than January 1, 2001, information available at the time this *Analysis* was written indicates that the department is proposing to extend all loan repayments over six years (to 2002-03). For these reasons, we recommend that DCA advise the Legislature at budget hearings (1) on its plan to ensure adequate funding for the proposed enforcement activities and (2) under what authority it has extended the Contractors’ License Fund loan repayment schedule.

LEGISLATURE SHOULD FREEZE CURRENT CONTRACT PENDING DEMONSTRATION OF IMPROVED PERFORMANCE

We recommend that the Legislature, in lieu of adopting the new operational flexibilities the department is proposing under performance-based budgeting, renew the existing contract for the budget year.

Background. Under Chapter 641, Statutes of 1993 (SB 500, Hill), the DCA is one of four departments entering the fourth year of a performance budgeting pilot project. The pilot project involves the department's administrative divisions, and the seven bureaus (including the three boards scheduled to sunset on July 1, 1997) and two programs under the statutory control of the Director. None of the remaining independent regulatory boards are included in the pilot project. During the first three years of the pilot, the Legislature approved budget contracts that gave the DCA various operational flexibilities. (See our analysis of the Department of Finance in this section of the *Analysis* for an overview of the status of the statewide pilot.)

1997-98 Budget Proposal Includes New Flexibilities. Expenditures for the divisions, bureaus, and programs under performance-based budgeting are expected to be \$157 million, a 2 percent increase over estimated current-year expenditures. The budget bill includes language that would, among other things, give the DCA discretion to (1) increase or decrease 1997-98 spending by up to 15 percent among the activities under performance budgeting as long as expenditures do not exceed the total budgeted amount and (2) administratively establish positions without Department of Finance approval. This budget language is similar to language in the *1996-97 Budget Act*. In addition, the budget bill contains several new flexibilities that would grant relief from administrative and statutory controls over items such as out-of-state travel and prepayment of vendor contracts.

Analyst's Recommendation. The DCA has not been able to provide evidence of significant performance improvements due to the existing flexibilities. Furthermore, the DCA has justified the new flexibilities primarily on the basis that the flexibilities have been granted to other departments in the pilot program. Thus, we believe that it is premature to grant new flexibilities to the department. With respect to relief from administrative controls (except for those which may be tied to budget act control sections), we see no reason for the Legislature to adopt budget act language to exempt a department from administratively established rules. The administration can grant these exemptions on their own initiative. Therefore, we recommend that in lieu of adopting the proposal for new flexibilities, the Legislature renew the current-year budget contract

for 1997-98 and consider changes only when DCA can demonstrate significant performance improvements as the result of statutory exemptions provided through its current budget contract.

AUGMENTATION FOR CALL CENTER UNNECESSARY

We recommend that the Legislature delete \$880,000 and 13.5 positions because the department has not justified the need for this augmentation. (Reduce Item 1111-001-0001 by \$880,000.)

The budget proposes \$880,000 from the General Fund and 13.5 positions for the department to offset costs associated with answering calls to its toll-free inquiry/complaint (800 number) telephone line that the department claims are not directly related to department programs. The department established the combination automated and live operator call center in 1994 to handle telephone inquiries and complaints from consumers and department licensees. The department indicates that approximately 30 percent of telephone calls coming into the center concern matters not under DCA's jurisdiction, such as landlord/tenant issues, vehicle registration and driver's license renewals inquiries, and personal credit questions.

According to DCA, because call center operators are tied-up with non-jurisdictional calls, department licensees and consumers of business activities regulated by the department experience service delays. Available information, however, does not indicate that callers are experiencing extraordinary delays in service. In fact, the department's December 1996 year-end report on its participation in the performance-based budgeting pilot indicates that, despite growth in call volume and increases in caller time on hold, consumer satisfaction with service delivery was *excellent*. Furthermore, we believe that several options exist for the department to reduce operator workload associated with handling nonjurisdictional calls. For example, the call center currently offers recorded landlord/tenant information. The department should consider expanding recorded information programs for other frequently asked nonjurisdictional questions. In addition, the department should explore (as called for in its own report) further automation of the call center so that overall operator workload is reduced.

Given the department's report of customer satisfaction along with the options that exist for reducing costs associated with answering non-jurisdictional calls, we believe an augmentation to the call center is not justified. Furthermore, because the majority of the calls that are not directly

related to department programs appear to fall under the jurisdiction of special fund agencies and because the DCA itself is a special fund agency, we believe this activity is not a General Fund responsibility. Accordingly, we recommend that the Legislature delete \$880,000 under Item 1111-001-0001.

VARIOUS AUGMENTATIONS NOT JUSTIFIED

We recommend that the Legislature deny a total of \$1,161,000 for three augmentations—for (1) an Attorney General rate increase, (2) the Board of Barbering and Cosmetology, and (3) the Athletic Commission—because these augmentations are not justified.

Attorney General Rate Increase Should Be Accommodated Within Existing Resources

The budget proposes augmenting the legal services line item for 23 boards, 6 bureaus, and 1 program by a total of \$370,000 to offset the effects of a 2 percent increase in hourly rates charged by the Attorney General. (According to the Department of Justice, budget-year rates for attorney and paralegal services will increase from \$98 and \$52 to \$100 and \$53, respectively.) The amounts requested range from \$1,000 to \$120,000 and are based on the assumption that the affected agencies will use the same level of legal hours as in the current year. To our knowledge, the DCA is the *only* department proposing to increase their budget for this 2 percent hourly rate change.

Costs Should Be Absorbable. The Attorney General hourly rate increase should not require each board, bureau, and program to increase their base budgets. For example, the proposed augmentations represent only between 0.04 percent and 0.51 percent of all individual expenditures for the programs requesting the adjustment. An increase of this magnitude should be absorbable within existing funds. This is especially true given that the budget amount for Attorney General costs is an *estimate of potential need* for legal services and is not based on specific cases and associated hourly legal services requirements. Consequently, we can find no analytical basis to recommend that the Legislature provide the DCA the additional funds for legal services costs. Thus, we recommend that the Legislature delete \$370,000 included in the budget under various items for Attorney General hourly rate increases.

Board of Barbering and Cosmetology Augmentations Inappropriate

The budget proposes the following augmentations totaling \$668,000 and 16.5 positions for the board:

- Workload adjustment for citation appeals (\$257,000 and 5.5 positions).
- Workload adjustment for examination administration (\$240,000 and 11 positions).
- Distribution of board publications (\$118,000).
- Toll-free telephone line (\$53,000).

Board to Be Restructured as a Bureau. As mentioned above, the Board of Barbering and Cosmetology is scheduled to sunset at the beginning of the budget year, with its functions handled by a bureau within the DCA. Consequently, the activities and program costs in this regulatory area are subject to possible modification. Thus, we believe it would be premature to approve any of the proposed augmentations. Furthermore, the department should realize savings associated with the elimination of the board structure. Therefore, if these activities are priority concerns, the department can work within its current resources and any savings due to economies of scale associated with merging the board into the department to fund them. In addition, because the new bureau will be under performance-based budgeting, the department should have greater budget flexibility to accommodate the expenditures for these projects within existing resources. For these reasons, we recommend that the Legislature delete \$668,000 and 16.5 positions from Item 1111-010-0702.

General Fund Augmentations for Athletic Commission Not Justified

The budget proposes two General Fund augmentations totaling \$123,000 to support two new Athletic Commission activities:

- Initiate direct state regulation of amateur boxing (\$97,000 and two positions).
- Conduct closed hearings for professional boxing applicants who test positive for the AIDS virus (\$26,000).

Amateur Boxing Self-Regulation Should Continue. As allowed under current law, the regulation of amateur boxing has been delegated to nonprofit organizations since 1986. The commission is now proposing to discontinue this practice and have the state assume this regulatory activ-

ity. During the ten years of self-regulation, there have been no identified chronic problems with self-regulation of amateur boxing or any significant risk to the state from delegating this responsibility. Because self-regulation appears to be working well, we believe that the commission should not bring this activity back under state responsibility. Therefore, we recommend that the Legislature delete \$97,000 and two positions included in the budget for this activity.

Additional Hearings Unnecessary. Chapter 376, Statutes of 1996 (AB 2472, Hoge and Miller), requires that all individuals applying for a professional boxer license (or renewal of a license) must show proof of testing negative for the AIDS virus. Under this legislation, applicants who test positive have the right to request a closed hearing to appeal license denials. The commission does not have any experience under this new requirement. The commission, however, estimates that it will require \$26,000 annually in travel and per diem costs to accommodate an estimated five requests per year for closed hearings. Instead of augmenting their budget, the commission should be able to accommodate these requests in the same manner that other protest hearings are handled—at regularly scheduled commission meetings (which are held every six weeks). Furthermore, the administration advised the Legislature when the legislation was under consideration that costs for this program would be minor and absorbable. Given that there appears to be no need to schedule extra hearings, we recommend that the Legislature delete \$26,000.

Based on these factors, we recommend that the Legislature delete \$123,000 and two positions under Item 1140-001-0001.

AUGMENTATION REQUESTS FOR SUNSET BOARDS ARE PREMATURE

We recommend that the Legislature not approve \$2.3 million and five positions because it is premature to initiate these program modifications for boards that currently are under sunset review by the Legislature.

As summarized in Figure 8, the budget proposes several augmentations—totaling \$2.3 million and five positions—for five boards currently undergoing sunset review.

Program Modifications Possible. As mentioned above, over a period of three years all the boards within the department will undergo sunset review. Under this process, the Legislature is currently reviewing and analyzing the effectiveness and need for each of the boards listed in Figure 8. Based on this review, the Legislature may choose, once final

recommendations are made by the joint review committee at the end of February 1997, to completely eliminate the regulatory activities of these boards, sunset these boards into bureaus within the department, modify their programs, or retain them in their existing form.

Figure 8		
Sunset Boards Augmentation Requests		
(Dollars in Thousands)		
Proposal	Amount	Positions
Contractors' State License Board		
Workload adjustment to increase underground economy enforcement program	\$371	3
Baseline adjustment for increases in operating expenses	327	—
Workload adjustment for enforcement cases	322	—
Update examinations	180	—
Subtotals	(\$1,200)	(3)
Board of Registration for Engineers and Land Surveyors		
Distribution of board publication	\$140	—
Clerical support	50	1
Subtotals	(\$190)	(1)
Board of Pharmacy		
Public education program	\$263	1
Vehicle replacement	245	—
Subtotals	(\$508)	(1)
Structural Pest Control Board		
Update Examination	\$196	—
Distribution of board publication	66	—
Cost increase of interagency agreement with the Department of Pesticide Regulation	65	—
Subtotals	(\$327)	—
Veterinary Medical Board		
Workload adjustment for enforcement cases	\$72	—
Examination administration	25	—
Subtotals	(\$97)	—
Totals	\$2,322	5

Until the Legislature takes action to resolve the status of each of these boards, we believe it would be premature to approve any of the proposed augmentations. Based on our review, there is no apparent urgent need for any of the augmentation requests listed in Figure 8.

Therefore, we recommend that the Legislature delete \$2.3 million and five positions included in the budget for the boards under sunset review as shown in Figure 6. If the Legislature takes final action under the sunset review of any of these boards prior to completion of budget hearings, legislative consideration of the proposed augmentations or other adjustments to their respective budgets would be warranted



DEPARTMENT OF FAIR EMPLOYMENT AND HOUSING (1700)

The Department of Fair Employment and Housing (DFEH) enforces laws that promote equal opportunity in housing, employment, public accommodations, and that protect citizens from hate violence. Specifically, DFEH has responsibility for enforcing the state's main equal opportunity law, the Fair Employment and Housing Act, and resolving complaints in a timely manner.

The budget proposes expenditures of \$18.7 million (\$14.7 million General Fund and \$4 million federal funds) for support of DFEH in 1997-98. This represents a General Fund increase of \$2.5 million (20 percent) over estimated current-year General Fund expenditures. The increase is the result of an augmentation for additional staff to investigate employment discrimination complaints.

Audit Indicates Permanent Positions Not Justified

We recommend that the Legislature delete \$2.5 million and 42 positions because the department has not justified its base level of funding, let alone additional resources. (Reduce Item 1700-001-0001 by \$2.5 million.)

The budget proposes \$2.5 million from the General Fund for the department to add 42 positions to investigate employment discrimination complaints. The proposal would bring the department's staffing level to 295 personnel years. The department has grown significantly in recent years, as staff has increased by 41 percent since the 1994-95 level.

Background. In 1995-96, the department's budget was augmented by \$2.5 million and 41 positions for a similar purpose—investigation of employment discrimination complaints. This augmentation was based on the premise that additional staff could reduce the backlog in employment discrimination cases and process these cases within the statutorily re-

quired one-year period to move a case to prosecution. We had expressed concerns that the department had not justified the augmentation. Our findings indicated that the number of cases at risk of missing the one-year deadline for moving to the prosecution stage was already declining without the additional positions. Additionally, DFEH staff indicated that around one-half of the backlogged cases were probably not meritorious. For 1996-97, the Legislature deleted funding for 11 of the 41 positions added in 1995-96 and provided \$1.9 million in funding for the remaining 30 positions as two-year limited-term positions to work off the backlog beginning in the current year.

The budget-year request would *add another 42 positions on a permanent basis*—positions which would be in addition to the existing 30 two-year, limited-term positions approved by the Legislature in 1996-97.

In response to our findings and concerns over the department's complaint processing procedures, the Legislature adopted language in the *1996-97 Budget Act* requiring the Bureau of State Audits (BSA) to conduct a comprehensive fiscal and performance audit of the department.

Audit Indicates Improvements Are Needed. The January 1997 audit report by the BSA indicates that the department has several inefficient complaint processing procedures and case management practices. For example, the audit suggests that the department can improve complaint processing time by developing a team approach to case management, conducting abbreviated investigations upon initial receipt of complaints, and correcting data and inventory errors in its existing case management information system. In addition, the audit report concludes, among other things, that any request for permanent staff is inappropriate given that the department is unable to provide reliable workload projections and indicators.

Analyst's Recommendation. In view of the concerns over the department's managements practices—reinforced by the BSA audit—and the 30 two-year, limited-term positions provided by the Legislature in 1996-97, we find no basis for adding another 42 permanent positions to the department. Therefore, we recommend that the Legislature delete the requested \$2.5 million and 42 permanent positions. If upon implementing the changes recommended in the audit and improving its complaint processing procedures the department finds that additional positions are needed to manage workload, it could submit a request for the Legislature's consideration in future budgets. Until these actions are taken, however, increasing the number of staff is not warranted.

ENERGY RESOURCES CONSERVATION AND DEVELOPMENT COMMISSION (3360)

The Energy Resources Conservation and Development Commission (commonly referred to as the California Energy Commission) is responsible for forecasting energy supply and demands, developing and implementing energy conservation measures, conducting energy-related research and development programs, and siting major power plants.

The budget proposes commission expenditures of \$118.8 million from various state and federal funds in 1997-98. This is \$50.4 million or 74 percent more than current-year estimated expenditures. The increase includes \$66.8 million for two programs—Public Interest Research, Development and Demonstration Program and the Public Interest Renewable Resource Technology Program—established by Chapter 854, Statutes of 1996 (AB 1890, Brulte). This legislation provides for a restructuring of the California electricity industry. This increase is offset by reductions in spending for (1) various energy projects and assessments (\$11.5 million) and (2) the Katz School Bus program (\$5.2 million).

New Energy Programs Under Electricity Industry Restructuring

We recommend that the Legislature not approve the request for \$66.8 million for two new programs established under recently enacted legislation restructuring the electricity industry until the commission submits to the Legislature an implementation plan for each program.

The budget proposes a total of \$66.8 million in expenditure authority for the commission for the two programs established by the Legislature in Chapter 854. In addition, language has been included in the budget bill to (1) extend the availability of funds for these programs by one year (to two years) and (2) modify current requirements in the Public Contract Code concerning proposal solicitation and contract procedures.

Under Chapter 854, the Legislature took steps to deregulate electrical generation in California. Coupled with these actions, the Legislature established programs for renewable electricity generation, public interest research, development and demonstration activities, energy efficiency, and low-income programs. Funding for these programs is collected from investor-owned utilities by the state Public Utilities Commission. The moneys are then transferred to the Energy Commission for administration and implementation of the programs. The expenditure of the funds are dependent on legislative action.

Public Interest Research, Development and Demonstration Program. The budget proposes \$21.1 million expenditure authority for this program. This amount includes \$794,000 to add seven positions and technical support to implement and administer the program. The commission indicates that the request for this level of additional staff is based on redirection of existing staff and contract support, on an as needed basis beginning in the current year. The commission, however, has not identified what staffing level will be required in the budget year and thereafter.

The commission indicates that beginning January 1, 1998, at least \$62.5 million will be collected annually from the ratepayers of investor-owned utilities to finance this program. The commission's timetable for implementing this program calls for it to: (1) develop a plan by June 30, 1997; (2) streamline requirements for solicitation, contractor selection, and contract negotiations by March 16, 1997; and (3) prepare and conduct solicitations July 1997 through April 1998. Projects would be awarded January 1998 through June 1998. The commission indicates that this timetable will require modifications of current proposal solicitation and contracting requirements. As mentioned above, the budget bill contains language to modify these requirements for this program and the program discussed below.

Public Interest Renewable Resource Technology Program. The budget includes \$45.7 million for this program. The commission indicates that about three staff positions and contract support will be redirected to plan and implement this program. The commission, however, has not identified what staffing level will be required in the budget year or thereafter. A total of \$540 million is expected to be collected from ratepayers of investor-owned utilities over the five-year period ending December 31, 2001. The commission's timetable for this program involves (1) planning and implementing the program July 1997 through January 1998, (2) administering the program and awarding contracts and grants January 1998 through December 2001, and (3) closing out the program by June 2002.

No Information on Program Plans or Implementation. The commission has not developed a plan or established criteria for selecting and

awarding projects under these programs. We believe that the Legislature should have available a well-defined program—including details of the commission's implementation, administration, and development plan—with clearly defined criteria and priority-setting procedures before the commission is given expenditure authority to embark on these programs. In addition, for the renewable resource technology program, Chapter 854 requires the commission to submit a report to the Legislature by March 31, 1997 with recommendations regarding market-based mechanisms to allocate available funds for programs.

Based on the lack of program information and the legislative requirement for the forthcoming March 31 report, we recommend that the Legislature not approve the \$66.8 million requested for these new programs, or the budget bill language, until the necessary information is available for legislative review.



AGRICULTURAL LABOR RELATIONS BOARD (8300)

Agricultural Labor Relations Board. The Agricultural Labor Relations Board (ALRB) protects the rights of agricultural workers to join employee unions, bargain collectively with their employers, and engage in activities through labor organizations of their own choosing. In order to accomplish its work, the agency is split into two divisions: (1) the General Counsel, whose employees run elections and investigate charges of unfair labor practices, and (2) the board, which certifies elections, and adjudicates and mediates unfair labor practices.

The budget proposes General Fund expenditures of \$4.6 million for the support of the ALRB in 1997-98. This is \$237,000 (5 percent) more than estimated current-year expenditures.

Public Employment Relations Board. The Public Employment Relations Board (PERB) protects the rights of public education and state employees to join employee organizations and engage in collective bargaining with their employers regarding salaries, wages, and working conditions. Like the ALRB, the PERB reviews, mediates, and, if needed, adjudicates charges of unfair labor practices and conducts employee union elections.

The budget proposes expenditures of \$4.3 million for support of the PERB in 1997-98. This is \$220,000 (5 percent) more than estimated expenditures in the current year.

Eliminate the ALRB and Transfer its Remaining Duties to the PERB

In view of Agricultural Labor Relations Board's persistently light workload, we recommend legislation eliminating the board and transferring its duties to the Public Employment Relations Board. This would result in budget-year savings to the General Fund of \$1,067,000 and future annual savings of at least \$2,136,000. (Reduce Item 8300-001-0001 by \$2,278,000 and increase Item 8320-001-0001 by \$1,211,000.)

The ALRB was created in 1975 with the passage of the Agricultural Labor Relations Act (Chapter 1, Statutes of 1975, Third Extraordinary Session). The ALRB's workload consists of (1) certifying farm worker union elections, (2) adjudicating unfair labor practices, and (3) collecting restitution from farm employers found guilty of violating the state's collective bargaining laws. The ALRB was created because federal collective bargaining laws specifically denied coverage to agricultural workers.

Light Workload. In our *1995-96 Analysis of the Budget Bill*, we noted that the board's two major workloads—election certification and unfair labor practice complaints—showed a dramatic falloff after an early flurry of cases in the years immediately following passage of the Agricultural Labor Relations Act in 1975. For example, Figure 9 shows that ALRB election certifications peaked in the years immediately following creation of the ALRB (1975-1977), then declined sharply and permanently. Our current review indicates that this trend continues. Workload growth from increased union activity has not materialized as illustrated by the fact that the ALRB certified just six elections in 1995-96, an all-time low and 75 percent less than the projected 25 elections. Figure 10 (see page 48) indicates the same phenomena in the issuance of complaints by the board (26 in 1995-96). Through December of the current fiscal year, the ALRB had issued 12 unfair labor practice complaints and held *no* elections.

Figure 9

**Agricultural Labor Relations Board
Elections Held
1975-76 Through 1995-96**

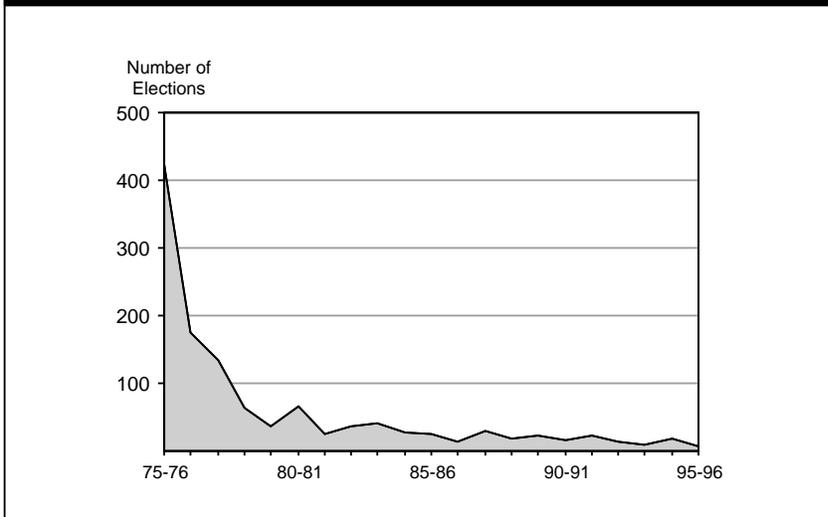
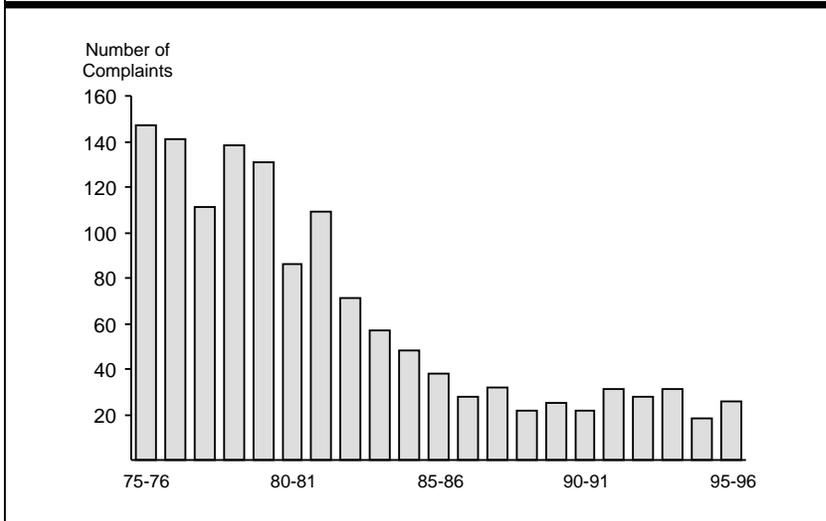


Figure 10

**Agricultural Labor Relations Board
Complaints Issued
1975-76 Through 1995-96**



Jurisdictional Limits. As noted above, federal law specifically excludes collective bargaining for agricultural workers. In our prior analysis of this item, we noted that board workload would most likely be reduced even further due to a pending decision on jurisdiction over agricultural workers that pack produce in the field. Final resolution of this issue at the federal level placed this category of workers under the jurisdiction of the National Labor Relations Board (NLRB). This is the case even though the “packer” may have just hours or minutes earlier been cutting the produce—an activity that would have put the worker under the jurisdiction of the ALRB. Because of this decision, the number of worker activities covered by state law has been reduced, and ALRB’s already slight workload continues to decrease even further.

Given the board’s ongoing light workload, we continue to believe greater efficiencies would be achieved by eliminating the ALRB and transferring enforcement of the state’s farm labor collective bargaining laws to PERB. Under this arrangement, PERB could handle this important workload, and the state could save significant monies by eliminating duplicative administrative overhead. Specifically, our review indicates that the work of the ALRB board members and their legal and administrative support positions (budgeted at \$2,136,000 in 1997-98) could be absorbed by the PERB. Funds budgeted for the ALRB’s General Counsel

administration (\$2,421,000 in 1997-98) would be transferred to the PERB. (This amount could probably be reduced in future years, given other likely efficiencies from consolidation.)

Analyst's Recommendation. In view of the above, we recommend that the Legislature enact legislation to eliminate the ALRB—as of January 1, 1998—and move its residual functions and workload, with necessary staff, to the PERB. Accordingly, we recommend the Legislature: (1) provide half-year funding (July to December) for the ALRB (reduce Item 8300-001-0001 by \$2,278,000) and (2) provide half-year funding (January to June) to PERB for its new responsibilities (increase Item 8320-001-0001 by \$1,211,000). This recommended consolidation would save the General Fund at least \$1,067,000 in 1997-98, with annual savings of at least \$2,136,000 in future years. We also recommend that the legislation include those changes needed to conform the Agricultural Labor Relations Act with the transfer of enforcement to the PERB.

Deposit Undisbursed Unpaid Wages Into the General Fund

We recommend the Legislature enact legislation requiring that unpaid wages collected from an employer found guilty of unfair labor practices be deposited into the General Fund when the worker eligible to receive these wages cannot be located.

The ALRB is required (pursuant to Labor Code Section 1148) to follow the practices and procedures of the NLRB in carrying out its duties. Under NLRB policy, no penalty fine is assessed to an employer found guilty of committing an unfair labor practice. Instead, the employer must compensate the worker for unpaid wages plus interest. If the ALRB does not locate the workers within two years, however, the funds are returned to the employer. The amounts returned to employers vary greatly from year-to-year. In 1995-96, for example, \$193,000 was returned to employers, while in 1994-95 no funds were returned.

Under this policy, some employers who break the law are not held accountable. In contrast to the ALRB laws, the Labor Code provisions relating to the Department of Industrial Relations (DIR) require that unpaid wages either be returned to the appropriate workers or deposited into the General Fund. None of the unpaid wages collected by the DIR are returned to the employer. We believe the DIR approach is more appropriate, and therefore recommend that the Legislature enact legislation to require the deposit of any undisbursed revenue into the General Fund.

DEPARTMENT OF INDUSTRIAL RELATIONS (8350)

The mission of the Department of Industrial Relations (DIR) is to protect the workforce of California, improve working conditions, and advance opportunities for profitable employment. These responsibilities are carried out through three major programs: the adjudication of workers' compensation disputes; the prevention of industrial injuries and deaths; and the enforcement of laws relating to wages, hours, and working conditions.

In addition, the department (1) regulates self-insured workers' compensation plans, (2) provides workers' compensation payments to injured workers of uninsured employers and other special categories of employees, (3) offers conciliation services in labor disputes, and (4) conducts and disseminates labor force research.

The budget proposes expenditures totaling \$219 million for the department in 1997-98, which is the same as the estimated expenditures for the current year. The request includes \$140 million from the General Fund, a 2 percent increase.

Prevailing Wage Changes

We recommend that the Legislature delete \$1,266,000 and 20 personnel-years to determine prevailing wages because the Legislature denied this request in 1996-97 and the DIR has not justified the need for additional personnel in the budget year. (Reduce Item 8350-001-0001 by \$1,266,000.)

The budget includes \$1,266,000 from the General Fund and 20 personnel-years for the Division of Labor Statistics and Research (DLSR) to determine prevailing wages for public works. Existing law requires that workers employed on public works projects be paid not less than the generally prevailing rate of wages for work of a similar character in the locality in which the public work is performed. The DIR is responsible for determining these prevailing rates.

Background. The budget request is the same as a request in the *1996-97 Governor's Budget* to do surveying to implement changes to the regulations governing the methodology for determining prevailing wage. At that time DIR was proposing to change the methodology for setting prevailing wages. Under the long-standing methodology, DIR deemed the most-frequently occurring single wage rate for each craft and locality—the “modal” rate—as the prevailing rate. (Wage rates set by collective bargaining agreements tend to be the most frequently occurring single rates in most crafts and localities, even where a minority of workers in a local craft are being paid these rates, because nonunion wage rates tend to vary highly from firm to firm and project to project.) The DIR was proposing new regulations that would set prevailing wages at (1) the single rate occurring at least 50 percent of the time in a given local craft, or (2) in the absence of such a rate, the weighted average rate. To implement the proposed changes, the DIR request in 1996-97 was to add 19 personnel-years at a cost of \$1,266,000 to conduct annual surveys for more than 4,000 job classifications in each of the 58 counties. The Legislature denied this request.

New Regulations Adopted and in Effect January 1997. After the *1996-97 Budget Act* was approved, DIR adopted the new regulations that were proposed as outlined above. These new regulations for determining prevailing wage became effective in late January 1997. The budget proposes to add 20 personnel-years to DIR, at an annual General Fund cost of \$1.3 million, to conduct the annual surveys.

As mentioned above, the budget request associated with the new regulations is the same as submitted to the Legislature in the *1996-97 Budget Bill*. At that time we recommended that the Legislature deny the request because the DIR's proposal to implement substantive changes in prevailing wage regulations was a policy proposal that we believed should be considered in prevailing wage legislation rather than in the budget bill. We also suggested that if the Legislature agreed to the proposed methodology, additional staff and an augmentation to the DIR budget might be necessary but at a lower amount than requested. We indicated for example, that the DIR could substantially reduce the cost of implementing the changes in regulations by dividing the state, for survey purposes, into a reasonable number of construction labor market areas rather than all 58 counties.

Presumably, the DIR has determined that prevailing wages can be set under the new regulations using existing staff because under the DIR's scheme the new regulations will be in effect for five months in the current year without an increase in staff. Consequently, the DIR should continue at the current budget and staff level. If after gaining experience under the new regulations and considering less costly ways of performing the

surveys DIR can demonstrate the need for additional staff, a request based on actual workload experience would warrant legislative consideration.

At this time, however, we recommend the Legislature delete the requested \$1,266,000 and 20 personnel-years. (Reduce Item 8350-001-0001 by \$1,266,000.)

Eliminate Managed Care Unit

We recommend that the Legislature delete \$395,000 and ten positions for the Managed Care Unit within the Division of Workers' Compensation because there is virtually no workload for these positions and there are insufficient fee revenues to support the program. (Delete Item 8350-001-0032.)

The 1997-98 Budget Act purposes \$395,000 and ten positions for the Managed Care Unit. The primary responsibility of the Managed Care Unit is the evaluation of new health care organization (HCO) applicants for possible certification and the recertification of existing HCO's on a three-year cycle.

Background. In 1993-94, the Managed Care Program was established within the Division of Workers' Compensation as part of workers' compensation reform legislation adopted in 1993. Under the Managed Care Program, private and not-for-profit health care providers apply to the state for eligibility to become an HCO that, upon certification, may contract with California employers to provide managed care for employees requiring medical care due to workers' compensation claims. To become a workers' compensation HCO, an applicant must first be approved by the Department of Insurance (for a disability insurer) or the Department of Corporations (for a Knox-Keene primary care health maintenance organization or a workers' compensation health care provider organization). Subsequent to this approval, DIR must certify the applicant by evaluating the HCO's ability to offer adequate occupational medical and health care services for workers' compensation beneficiaries. The applicant HCO is assessed an application fee, and, if certified by DIR, charged an annual fee per enrollee in the HCO. Revenues from these two sources are deposited in the Workers' Compensation Managed Care Fund, which supports the Managed Care Unit. In 1994-95 the Workers' Compensation Managed Care Fund received a General Fund loan of \$1.7 million to provide an initial cash base for the Managed Care Program.

Managed Care Workload Continues to Fall Below Projections. The difficulty associated with the Managed Care Program is simply that very few organizations have applied to be an HCO. Since the program's incep-

tion in 1994, only eight organizations have been certified by the Managed Care Unit as HCOs. In 1994-95, the Managed Care Unit was funded based on an estimate that there would be approximately 50 HCO applicants that year. In actuality, only 16 organizations have applied to be an HCO since the program's beginning. More significantly, there has been only one HCO applicant since December 1995. Since the primary function of the Managed Care Unit is to evaluate and certify HCO applicants, it appears that there has been virtually no workload for over a year with which to justify the ten positions budgeted for the unit. In fact, the Governor's budget estimates that there will be only \$68,000 of fee revenue in the budget year versus a cost of \$395,000 to fund the ten positions and associated expenses for the Managed Care Unit. In short, there is strong evidence that market conditions are such that the Managed Care Program is not receiving enough response from possible health care providers to justify continuing to fund the program. Thus, it makes little sense to continue to budget the ten positions and associated operating expenses for the Managed Care Unit.

Program Costs Exceed Revenues. As mentioned above, the Workers' Compensation Managed Care Fund was initially given a \$1.7 million General Fund loan. This loan was to be repaid, with interest, by June 30, 1997. The *1997-98 Budget Bill* contains language that would extend the deadline for repayment until June 30, 1998. According to the Governor's budget, from 1994-95 (the program's initial year of funding) through 1997-98, the Managed Care Program will receive a total of \$176,000 in fee revenue—an average of \$44,000 per year. Based on this revenue plus the General Fund loan, the proposed expenditure in the budget year will leave a zero balance in the fund on June 30, 1998. Consequently, there will be virtually no funds to repay the General Fund loan on June 30, 1998 (as proposed in the budget) or to finance this program in 1998-99.

Given this situation, we recommend that the Legislature (1) delete \$395,000 and ten positions included in the budget for the Managed Care Program and (2) revert the balance of funds in the Workers' Compensation Managed Care Fund to the General Fund as a partial repayment of the General Fund loan. Any minor work remaining under the program could be handled within current budget and staff of the Division of Workers' Compensation.

DEPARTMENT OF FOOD AND AGRICULTURE (8570)

The Department of Food and Agriculture (DFA) promotes and protects the state's agriculture industry, develops California's agricultural policies, and assures accurate weights and measures in commerce. The department also supervises county agricultural commissioners and county sealers of weights and measures.

The budget includes \$191 million for DFA in 1997-98, a decrease of \$6.6 million (3.3 percent) from estimated current-year expenditures. The budget total includes General Fund expenditures of \$64 million, about 1 percent less than estimated current-year General Fund expenditures, mainly due to the elimination of the Market News program.

General Fund Monies Proposed For Pest Control Program

We recommend that the Legislature approve \$1 million in General Fund expenditures and seven positions on a two-year, limited-term basis so the department can demonstrate the benefits of the proposed pest control program and develop an alternative funding source.

Background. The budget includes \$1 million from the General Fund for a public education and enforcement program regarding the impact of bringing prohibited agricultural products into California. Previously, a similar program—the Airport Maritime Inspection Program (AMIP)—had been funded from special fees on international maritime shippers and airline carriers. A December 1995 California State Supreme Court ruling that made the collection of these special fees illegal forced the department to suspend the AMIP program. As a result, the department is proposing a scaled-back version of the AMIP program for the budget year. This new program—supported from the General Fund—would allow the department to continue plant quarantine public awareness campaigns, establish a toll-free inquiry/complaint (800 number) telephone line, and set up a compliance unit to investigate public reports of smuggling activities and sales of prohibited agricultural products. To educate the public about the impact of foreign pests on agriculture, the department proposes to use

three positions to, among other things, distribute educational materials (1) on airlines and at airports to foreign and domestic California-bound travelers; (2) at community and cultural fairs and festivals; and (3) to the travel industry. The compliance component of this program would include four positions to investigate public complaints of suspected smuggling activities and sales of prohibited agricultural products (which are violations of plant quarantine and animal disease laws).

General Fund Refund Obligation. As a result of the court ruling, the department is obligated to refund \$22.5 million (\$4 million to the maritime carriers and an estimated \$18.5 million to the airline carriers). Because the AMIP fund only had \$9.2 million in reserves when the program was suspended, the remaining refund amount (\$13.3 million) is a General Fund obligation. The department refunded the \$4 million owed to the maritime carriers in 1995-96 from the existing AMIP reserve. The budget includes \$7.4 million (\$2.2 million General Fund and the remaining AMIP reserve of \$5.2 million) to make refund payments in the current year. The department estimates that another \$11.1 million from the General Fund will be needed to make future-year repayments.

Analysis of the Proposal. In general, the department's proposal appears to have merit. We have some concerns, however, about the ongoing effectiveness of and funding source for the program. For example, the effectiveness of public awareness campaigns can be difficult to measure. In addition, the department's workload justification for the compliance component of the program is based on an unknown amount of public reporting of suspected smuggling and sales activities. Furthermore, the department should consider alternatives to permanent General Fund expenditures for this program.

For these reasons, we recommend that the Legislature approve the seven positions on a two-year, limited-term basis. The two years will allow the suspended program to be partially resumed, while also giving DFA and the Legislature an opportunity to evaluate program workload and effectiveness and determine if it should be continued permanently and how it should be funded. Because industry benefits from exotic pest control efforts, one of the alternatives DFA should evaluate is a proposal for the state and industry to share the costs of any permanent program activities.

Salary Increase for University of California Employees Should Not Require a General Fund Augmentation

We recommend that the Legislature delete a \$509,000 General Fund augmentation for a salary increase granted by the University of California (UC) to veterinary laboratory employees because either UC should

provide funding for the pay raises of these UC employees or the department should absorb the costs within current budget resources. (Reduce Item 8570-001-0001 by \$509,000.)

The budget proposes \$509,000 from the General Fund to pay for the salary and benefit increases of the employees of the California Veterinary Diagnostic Laboratory System (CVDLS). The DFA contracts with the laboratory system for diagnostic services for its animal disease control programs. Because the University of California (UC) manages and operates the CVDLS, the 152 employees at the system's five laboratories are UC employees and have been granted the same salary and benefit increases given to other UC employees.

We can find no analytical basis for providing additional funds to the department to pay salary increases granted by UC to UC employees. The UC should pay for the salary increase it grants to its employees from the funds UC had available when the salary increases were granted. This UC decision should not be an additional General Fund cost. If UC cannot pay for the salary increases from its own budget, then DFA should absorb the increased cost of this contract for laboratory services from within existing budget resources. This would be consistent with the budgets provided to other state departments, where no price increases have been given for operating expenses such as contracts.

Accordingly, we recommend that the Legislature delete \$509,000 included in the budget for laboratory employee salary and benefit increases.

Industry Should Pay For Agricultural Export Program

We recommend that the Legislature enact trailer bill legislation authorizing the Department of Food and Agriculture to assess the agricultural industry for the state's costs of the agricultural export liaison program on chemical residue regulations. Accordingly, we recommend that the Legislature structure the \$364,000 appropriation in Item 8570-001-0001 as a reimbursement.

The budget proposes \$364,000 from the General Fund for two positions and one-time equipment costs for the department to expand its efforts to relax international trade restrictions on the state's agricultural exports relating to chemical residue levels. Specifically, this program would (1) establish a database to provide information to industry on the import requirements of the state's trading partners and (2) provide state representation, through an agricultural export liaison, on an existing federal task force that is working to standardize and reduce trade restrictions on chemical residue levels.

The database will help DFA provide exporters with information on restrictions by product and country. The activities of the agricultural export liaison will also assist industry by working with the national task force to standardize international export restrictions. Clearly, this program is designed to aid and benefit private industry by increasing California agricultural exports. While it is appropriate for the state to play a role in promoting agricultural exports, we do not believe this is a General Fund responsibility. Therefore, we believe that industry, as the primary beneficiary of these state activities, should pay for these services.

Analyst's Recommendation. Based on the above discussion, we recommend the enactment of legislation, effective July 1, 1997, authorizing DFA to begin assessing the users of the database and the agricultural export liaison services a fee for these services. To implement this in the budget year, we further recommend that the Legislature structure the full amount requested in the budget year as a reimbursement to be paid to the Agriculture Fund. Adoption of this recommendation would result in General Fund savings of \$364,000 (including \$120,000 for a one-time equipment purchase) in 1997-98 and \$273,000 on an ongoing annual basis.

Medfly Program Update

We withhold making recommendations on the department's ongoing sterile Medfly release program pending receipt of the department's report that is due March 1, 1997.

The budget includes \$7.4 million from the General Fund for the department's Mediterranean Fruit Fly (Medfly) program. Through this program, the department originally indicated that it would continue the twice weekly aerial release of 125,000 sterile Medflies per square mile over a 2,100 square mile area of the Los Angeles Basin, bordered by Sylmar, San Bernaradino, Irvine, and the Pacific Ocean. Since full implementation of the program in September 1996, however, the department has released only 75,000 Medflies per square mile on a twice weekly basis.

The Legislature appropriated \$7.7 million for this purpose in the *1996-97 Budget Act* and adopted supplemental report language directing the department to submit a program progress report to the Legislature on or before March 1, 1997. Upon review of the March report, which should contain information on program effectiveness and progress in developing alternatives to the current program, we will, if appropriate, make recommendations to the Legislature concerning this program.



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 \$290.7 million (\$180.9 million General Fund) for BOE in 1997-98. This is \$6.2 million (2 percent) less than estimated current-year expenditures. The majority of this decrease is attributable to (1) one-time costs in 1996-97 for implementation of a new computer system for delinquent tax collection (\$1.3 million) and computer purchases for the audit program (\$1.6 million) and (2) board-mandated supervisor reductions (\$1.6 million) in 1997-98.

Legislature Needs More Information To Evaluate Requests

We recommend that the Legislature not approve \$4.7 million and 21 positions for the Board of Equalization (BOE) that are requested, for the most part, on the basis of potential revenue benefits or losses because the Legislature does not have sufficient information to review the validity of the methodology used by BOE to make revenue impact calculations. We further recommend that BOE submit a report to the Legislature evaluating the revenue impact of previous audit program augmentations.

In the Crosscutting Issues portion of this section of the *Analysis*, we recommend that the Legislature not approve three augmentations for BOE totaling \$4.7 million and 21 positions because the Legislature does not have sufficient information to evaluate the merits of these requests. The augmentations are justified primarily on the basis of potential revenue impact. Please see our crosscutting issue on the BOE and Franchise

Tax Board in this section for our analysis of these requests and their relationship to the state's audit programs.



FRANCHISE TAX BOARD (1730)

The Franchise Tax Board (FTB) is one of the state's major tax collecting 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. In addition, FTB collects child support and motor vehicle registration delinquencies. The three-member board that oversees the agency 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.

The budget total includes General Fund expenditures of \$334 million, about 1.5 percent less than estimated current-year General Fund expenditures. This small change is the net result of several large augmentations, (such as increased workload in tax return processing [new computer system] offset by reductions in one-time payments to computer system development vendors.)

Argumentation for Tourism Program Unnecessary

We recommend that the Legislature delete \$1.9 million in reimbursements from the Trade and Commerce Agency and 27 positions because the collection and enforcement of businesses' self-assessed fees should not be the responsibility of the state Franchise Tax Board. (Reduce Item 1730-001-0001 [g] and reimbursements by \$1.9 million.)

The budget proposes \$1.9 million in reimbursements (General Fund) from the Trade and Commerce Agency (TCA) for FTB to fund 27 positions in 1997-98 to administer provisions of the California Tourism Marketing Act, as authorized in Chapter 871, Statutes of 1995 (SB 256, Johnston).

Under the act, TCA is to hold an initial referendum of businesses that benefit from travel and tourism for the approval or rejection of a self-assessment to finance a tourism marketing program. The initial referendum is currently scheduled to be held during June and July 1997. If the referendum is approved, the assessments would be deposited in a nonstate fund subject to expenditure through the California Tourism Marketing Commission, a nonprofit corporation. TCA has requested FTB to administer the referendum and collect the assessments.

The FTB, through a Control Section 28.50 notification letter, requested authority to spend \$1.5 million from a General Fund transferred from TCA to initiate the program in the current year. In response to the Section 28.50 letter, the Joint Legislative Budget Committee advised that (1) it was unclear why FTB should be involved in an ongoing capacity and (2) TCA and FTB should spend only those funds needed for administering the initial referendum, which should be accomplished at far less cost than \$1.5 million.

Our review indicates that FTB is proceeding with the development of the program on the premises that the referendum will pass and that FTB will have an ongoing responsibility to collect and enforce the business self-assessment fee. According to FTB, the \$1.9 million in the budget would provide the staff and a new automated system to collect and enforce the self-assessments from these businesses. As noted above, however, it is not certain that the businesses will vote for the assessments. Furthermore, according to FTB, the \$1.5 million requested in the current year was to be used in part to initiate the hiring of these staff and to initiate the assessment and enforcement system. Given the Joint Legislative Budget Committee's response to that Section 28.50 notification, it was not clear at the time this analysis was written as to the status of that proposal.

We believe the collection and enforcement of self-assessed fees for deposit in a non-state fund for expenditure by a nonprofit corporation should not be the responsibility of a state agency—especially FTB. The board exists to ensure that state-required tax payments (and certain other legally required payments) are made. In our view, it is unwise to use the board's name and authority to collect a voluntary, privately assessed fee. Furthermore, we believe it is inappropriate to augment the FTB budget and authorize the hiring of staff for workload that may not exist in the budget year. Therefore, we recommend that the Legislature delete \$1.9 million in reimbursements and 27 positions included in the FTB budget for this program.

Legislature Needs More Information To Evaluate Requests

We recommend that the Legislature not approve \$14.2 million and 124 positions for the Franchise Tax Board (FTB) that are requested, for the most part, on the basis of potential revenue benefits or losses because the Legislature does not have sufficient information to review the validity of the methodology used by FTB to make revenue impact calculations. We further recommend that FTB submit a report to the Legislature evaluating the revenue impact of previous audit program augmentations.

In the Crosscutting Issues portion of this section of the *Analysis*, we recommend that the Legislature not approve three augmentations for FTB totaling \$14.2 million and 124 positions because the Legislature does not have sufficient information to evaluate the merits of these requests. These augmentations are justified primarily on the basis of potential revenue impact. Please see our crosscutting issue for our analysis of these requests and their relationship to the state's audit programs.



DEPARTMENT OF INFORMATION TECHNOLOGY (0505)

The Department of Information Technology (DOIT) is responsible for planning and overseeing the state's uses of information technology. The department is responsible for ensuring that appropriate plans, policies and procedures are in place to assure the successful implementation of information technology projects.

The budget proposes \$6.6 million for support of the department's operations in 1997-98, an increase of \$2.5 million, or 62 percent, over estimated current-year expenditures. Of the increase, \$600,000 would support eight new positions, and \$1.9 million would be expended on external consulting services.

Method of Funding the DOIT. With the exception of \$750,000 budgeted as reimbursements, the cost of operating the DOIT will be spread across all state agencies through the state pro rata plan. This method of funding has been adopted by the Department of Finance (DOF) in response to the Legislature's direction, in the *1996-97 Budget Act*, that the DOF establish a more equitable method of funding the DOIT's operation. The Legislature concluded that the previous method was inequitable because it required two state data centers to fund two-thirds of the DOIT's annual budget, while assigning no funding responsibility to many other state agencies which would receive far more services from the DOIT.

Departmental Responsibilities

Background. In 1995, the Legislature enacted major reform legislation relating to the planning, implementation and oversight of the state's information technology activities. This legislation—Chapter 508, Statutes of 1995 (SB 1, Alquist)—was the result of several legislative hearings and various reports including a report issued by our office in June 1994 entitled *Information Technology: An Important Tool for a More Cost-Effective Government*. The Legislature determined that major reform was necessary

in order to address multiple serious problems affecting the state's information technology activities. According to the DOIT, California state government spends about \$2 billion annually on such activities.

The centerpiece of this reform was to establish a new department (DOIT), reporting directly to the Governor, and to assign to it many specific responsibilities which, if accomplished, would improve the state's ability to apply information technology in a cost-effective manner, and improve the Legislature's confidence in major information technology initiatives. Figure 11 shows the major responsibilities assigned the DOIT by Chapter 508.

Department Is in the Process of Addressing Major Information Technology Issues. According to the department, it is on the verge of completing a number of tasks which must be accomplished in order for it to fulfill its statutory responsibilities. While many of the department's projects are still under development, one project—the California 2000 Program—has been highly visible and appears to be the most complete. We discuss this program in more detail below. Other important projects, including providing policy guidance to departments regarding the initiation and oversight of information technology projects, operational recovery, information security, and improved reporting to the Legislature regarding information technology projects, are in varying stages of progress.

Department Makes Progress Toward Year 2000 Conversion

The Department of Information Technology has provided leadership to state agencies in planning the conversion of their computer programs to accommodate the millennium change.

The state, like private sectors and governmental jurisdictions worldwide, must modify its computer programs to accommodate the year 2000. This is necessary because many computer programs were coded without anticipating the millennium change, and they simply will fail to perform accurately, or at all, unless coding changes are made. Given the reliance of many state programs on computer systems, departments have no practical option but to make the changes in order to avoid serious degradation in their ability to carry out important state programs. Virtually all state agencies are affected by this pending change, and there are millions of lines of computer coding which must be screened to identify needed changes. Some departments have already had to address this situation; for example, those that issue licenses with expiration dates after 2000.

Figure 11

**Department of Information Technology (DOIT)
Major Responsibilities under Ch 508/95 (SB 1, Alquist)**

- Oversee the management of information technology in state agencies, with authority to suspend or terminate projects.
- Develop and implement a strategy to facilitate information sharing among state computing systems.
- Determine which information technology applications should be statewide in scope, and ensure that such applications are not developed independently or duplicated by state agencies.
- Develop and maintain a computer-based file, accessible to the Legislature, of all approved information technology projects.
- Develop statewide policies and plans that recognize the interrelationships and impact of state activities on local governments, including local school systems, private companies that provide services to state agencies, and the federal government.
- Requires the DOIT to submit the following reports (due date):
 - Progress toward compliance with the provisions of the measure (July 1, 1996).
 - A plan for implementing the recommendations of the Governor's Task Force on Government Technology Policy and Procurement (October 1, 1996).
 - A method whereby the public may electronically access nonconfidential information via state telecommunications networks (January 1, 1997).
 - A preliminary assessment of the feasibility of consolidating the state's information technology activities (July 1, 1997).

DOIT Takes Positive Steps in Year 2000 Challenge. The administration initially focused attention on this problem in 1995 through the temporary Office of Information Technology established by the Governor. The DOIT enhanced the focus and has achieved a number of accomplishments in its

effort to guide state agencies to a successful resolution of the year 2000 challenge. These include establishing the California Project 2000 site on the Internet where state agencies can obtain information, ranging from state policy direction to the names of year 2000 conversion managers in each state agency. Also, in November 1996, DOIT issued the *California 2000 Program Guide* which is intended to help departments by describing the problem and identifying the DOIT's approach to addressing it. In addition, this guide solicited information from the departments which the DOIT believes it must have in order to carry out its statutory oversight responsibility. Although it is too early to determine how well the program guide will work, the DOIT's efforts are important and consistent with the Legislature's expressed intent that the DOIT provide statewide leadership in critical areas of information technology.

How Much Will the Year 2000 Change Cost, and How Will it Be Funded? In last year's *Analysis* we estimated that the total state cost to convert computer programs could exceed \$50 million, based on some preliminary estimates from a very small number of departments. Some observers think the cost will be substantially higher once all departments complete their assessment of the situation, as has been required by the DOIT in its *California 2000 Program Guide*. An accurate assessment of the potential cost is important, given that the budgets of most state agencies do not include funds to convert their computer programs. We discuss this funding issue in this *Analysis* in our discussion of the DOF (please see Item 8860 of this chapter), where we recommend that the DOF advise the Legislature during budget hearings as to the estimated cost to convert computer programs and how this cost will be budgeted.

Overall Performance Of Department Has Been Mixed

Although it is too early to conclude how well the department will eventually meet its statutory responsibilities, its performance to date has been mixed. Nevertheless, we recommend that the Legislature approve the budget request, but monitor the department's progress closely.

Although officially established on January 1, 1996, the department was essentially active before then in the form of the temporary Governor's Office of Information Technology, which was established in April 1995. In addition, the current Chief Information Officer was appointed by the Governor in September 1995. Consequently, the administration has had in excess of 18 months to address the various information technology problems identified in independent reports and subsequent legislative hearings.

As we pointed out earlier, the department has taken important steps in addressing the year 2000 change which has important fiscal implications for state agencies. Nevertheless, many significant problems remain unresolved despite the amount of time which has passed, and the fact that the DOIT has been provided all funds requested of the Legislature. These problems range from improving the state's ability to apply information technology successfully and in a cost-effective manner, to replacing the obsolete electronic mail system used by thousands of state employees.

We acknowledge that it is going to take time to implement the changes embodied in Chapter 508. However, relatively simple but important tasks have not been implemented, such as modifying project-related documentation submitted to the Legislature so as to provide members a better understanding of the status of major state information technology projects, or establishing training and certification programs for the managers of technology projects and related contracts in order to enhance the opportunities for project success. Below we discuss our concerns with the DOIT's performance to date.

Department's Oversight Track Record Is Spotty. Chapter 508 requires that the DOIT identify which applications of information technology should be statewide in scope, and ensure that such applications are not developed in isolation. Despite this requirement, several state agencies are in varying stages of planning or implementing costly new personnel management information systems—for example a \$22.6 million project proposed by Caltrans. This is being done at the same time that a consortium of key state agencies has been involved in a project initiated in 1995 by the State Controller's Office (SCO) which will lead ultimately to the replacement of the state's personnel and payroll systems currently operated and maintained by the SCO. Clearly, this is a situation which the DOIT is required by law to resolve, but so far has not, and the cost of developing multiple redundant systems will be substantial.

The DOIT has also delegated broad authority to the Health and Welfare Agency Data Center (HWDC) to upgrade costly mainframe computing systems. This delegation of authority is troubling because it removes oversight from such purchasers. Such oversight is important because: (1) a mainframe computer can cost several millions of dollars and the state needs to ensure that its data centers are not purchasing more capacity than is needed, (2) computer costs are a major determinant of the data center rates that are charged to other state agencies, and (3) the state needs to ensure that it is considering appropriate alternatives to mainframe computing.

DOIT Role in Assisting Troubled Projects Is Unclear. The DOIT was established in response to deficiencies in state planning, leadership, and oversight of information technology. The failure of the Department of Motor Vehicles' (DMV) information technology project has been cited by many as symptomatic of fundamental problems in the state's information technology infrastructure. To our knowledge no other state information technology project has failed since the DMV project was terminated. However, the state auditor in a January 1997 report on the Office of Emergency Services (OES) notes the partial failure of the OES' \$5 million Public Assistance Damage Survey Report Management Information System. Moreover, several major projects continue to experience problems. These include:

- The \$119 million California State Lottery's Scratcher Automation Project, which has experienced major problems, including the failure of the Lottery to develop computer applications in order to fulfill its contractual obligations.
- The Department of Corrections' Correctional Management Information System, a \$99.8 million project, has been delayed for over a year due to major differences of opinion between the state and the contractor as to the contractor's performance and obligations.
- The Integrated Revenue Information System project at the Board of Equalization, the largest component of a \$39 million project, is also experiencing major differences of opinion between the state and the contractor regarding the contractor's obligations.
- The \$313 million Statewide Automated Child Support System, a project managed by the HWDC, continues to grow in cost beyond initial and even revised estimates, and has encountered significant performance problems.

The departments managing these complex projects are applying their efforts to resolving project problems, and in many cases are using external consultants to help them. The DOIT's performance in terms of facilitating problem resolution for these projects is not clear; however, in the case of the Lottery system, DOIT involvement has been minimal despite a Memorandum of Understanding between the DOIT and the Lottery which the Legislature was advised would ensure a DOIT oversight role.

Required Reports Have Often Been Late and Fallen Short of Meeting the Legislature's Needs. As shown in Figure 1, Chapter 508 placed several specific reporting requirements on the DOIT. The reports have been submitted late and have not provided all of the information needed by the Legislature. The first report required of the DOIT was a progress report on compliance with the requirements of Chapter 508, including a

plan and schedule for complying with this legislation. This report, due by July 1, 1996, provided minimal or no indication of the task objectives, expected outcomes and schedules needed to comply with Chapter 508, and was unclear in some instances as to the DOIT's specific role.

The second required report, a plan for implementing the recommendations contained in a September 1994 report to the Governor by his Task Force on Government Technology Policy and Procurement, was both late and fell short of fulfilling the statutory requirement. The report was required to address each of the 21 specific recommendation made by the task force. The report, however, responded to only seven recommendations, two of which had been accomplished through Chapter 508. According to the DOIT, it elected to focus on what it perceived to be the seven most important recommendations; however, this is not consistent with the direction in Chapter 508. The status of other important recommendations is unclear, thereby depriving the Legislature of the information it sought through the reporting requirement.

A third required report, concerning DOIT's progress in implementing the provisions of Chapter 508, was due on December 1, 1996, but had not been released at the time this *Analysis* was prepared. Finally, a fourth report, addressing the issue of public electronic access to non-confidential public records, was due on January 1, 1997, but had not been issued at the time this *Analysis* was prepared.

Required Notification to the Legislature Also Falls Short of the Mark.

In approving the *1996-97 Budget Act* for the DOIT, the Legislature included, at the department's request, \$500,000 for a consultant study of the consolidation of the state's data centers, and the development of an implementation plan. The funding was made available contingent upon a 30-day notification to the Legislature explaining the objective and scope of the consultant study. In accordance with this condition, the DOIT advised the Legislature on September 27, 1996, of its intention to begin the project. In response, the Chair of the Joint Legislative Budget Committee advised the Director of the DOIT that his letter did not provide sufficient information to determine what the consultant would be asked to do or what were the expected deliverables. The DOIT subsequently selected a consulting firm to conduct the consolidation study.

Strategic Plan for State Telecommunications. The *1996-97 Budget Act* required the DOIT and the Department of General Services to submit a plan to the Legislature by October 31, 1996, for resolving several specific state telecommunications issues, including annual losses resulting from the operation of the California Network System (CALNET) and the potential for consolidating telecommunications networks. In response, the departments submitted on December 20, 1996, the *California Integrated*

Information Network (CIIN) strategic plan, which recommends the consolidation and divestiture of the state-owned telecommunications infrastructure. We have the following concerns with the report.

It is difficult to determine from the plan for consolidation and divestiture whether it is feasible and can be accomplished within the time frames it establishes. First, we disagree with one of the plan's fundamental premises, that in all instances the operation of telecommunications networks are neither "core competencies nor core responsibilities" of the state and therefore should be divested. While we have raised serious questions regarding CALNET, we are unaware of any analysis which indicates that the California Law Enforcement Telecommunications System (CLETS) operated by the Department of Justice, or the extensive telecommunications networks operated by the HWDC and the Teale Data Center, do not represent core competencies and responsibilities.

However, even if the premise were assumed to be valid, the plan's feasibility is uncertain because important details have yet to be disclosed, such as exactly what components of state telecommunications networks would be consolidated. Moreover, discussions with departmental managers indicate that there has been minimal consultation with the state agencies which operate and rely on state telecommunications networks. Failure to adequately involve key state departments carries with it a risk that the business needs of state agencies, and therefore, their ability to carry out important state programs effectively, will take second priority in a rush to divestiture.

We believe that the plan's schedule—to award by January 1, 1998 a contract to the private sector to provide state telecommunications services—is unrealistic for a number of reasons including the relative newness of the DOIT, and therefore the lack of a track record which would warrant confidence in its ability to meet the January 1, 1998 date. Moreover, the Department of General Services, the DOIT's partner in this endeavor, has a spotty record in terms of meeting schedules for the awarding of technology contracts. In addition, the competitive bid process itself entails many opportunities for delay, and the state's track record in technology procurement is generally one of repeated rescheduling.

Finally, one of the plan's goals is to raise the technical telecommunications expertise of state employees to a level "... commensurate with the expertise found in the most prestigious consulting and technical firms in the private sector." While we agree with this goal, we think that this is unlikely to occur because telecommunications expertise is highly sought after, with the best experts commanding salaries which the state cannot

match. Moreover, the plan does not propose a salary structure which would make the goal attainable.

In summary, we believe that it is questionable as to whether the plan in its current form provides a sound basis on which to proceed to dismantle a critical underpinning of the state's information technology infrastructure.

Documents From Departments in Support of Major Information Technology Projects Often Poorly Prepared. In general, state departments are required to advise the Legislature as to (1) proposed new information technology projects and (2) significant changes in cost, benefits, or schedules to previously approved projects. State departments fulfill this requirement by notifying the Legislature in writing concerning proposed new projects, and providing a special project report when significant changes occur to existing projects, and a post-implementation evaluation report when a project is completed.

In many cases, the documents provided to the Legislature are difficult to understand because they are poorly prepared and do not contain important summary information. To correct at least a part of this problem, Chapter 508 required that these documents contain specific summary information at the front of the document. The DOIT, which is required by Chapter 508 to establish policies and procedures (including the format for information technology documents) has yet to do so. Consequently, many of the documents sent to the Legislature to apprise it of major information technology projects continue to be obscure.

DOIT Decision Is Inconsistent With Legislative Intent. The Legislature has, at various hearings, expressed its intent that state departments define their needs, rather than technical solutions, and allow the vendor community to propose its solutions through a competitive process. Contrary to this intent, the DOIT approved a Department of Consumer Affairs (DCA) project to implement an Integrated Consumer Protection System, but allowed the department to specify the solution after the DCA rejected vendor proposals on the basis that they were too costly. The project approved by the DOIT not only allowed the DCA to stipulate the technical solution to be employed, but also involved a sole-source contract award which we believe is generally contrary to both Legislative and Executive Branch policies governing competitive acquisition.

What Should the Legislature Do? As discussed above, the DOIT's performance has been mixed, and on balance has not been as responsive to Chapter 508 as the Legislature intended. A number of major information technology issues remain unresolved, and it is not at all clear

whether, or when, the DOIT will succeed in its efforts to fulfill its statutory charter.

In our judgement, close monitoring of the DOIT is warranted given its performance to date and the state's substantial dependency on information technology. We recommend that the proposed budget for the DOIT be approved, and that the Legislature ensure, through legislative oversight hearings, that the DOIT complies with the requirements and directions of Chapter 508.

Project Cost and Schedule Estimates Are Frequently Inaccurate

We recommend that the Legislature adopt supplemental report language requiring that the Department of Information Technology, in conjunction with the Department of Finance, adopt a policy requiring that feasibility study report transmittal letters and special project reports contain an indication of the administration's assessment of the sensitivity to change of the costs, benefits, and schedules contained in these documents.

In the individual departmental writeups of this *Analysis*, we identify several major information technology projects where costs have increased significantly above the original or updated estimates. The problem of inaccurate project estimates is not new. As a result, the Legislature continues to be asked to approve budgets for information technology projects which are based on cost estimates which are likely to increase. Schedules are often unrealistic as well. Whether benefit estimates experience the same inaccuracies is more difficult to determine, as few projects are ever completed to the extent that a post-Implementation evaluation report is prepared, which would address the extent to which estimated benefits were in fact achieved.

Given this situation, we believe that feasibility study report (FSR) transmittal letters and special project reports (SPRs) for information technology projects should address the probability that cost, benefit, and schedule estimates are likely to be accurate, including any qualifications regarding those estimates. To help improve the meaningfulness of budget requests based on estimates contained in information technology project-related documents, we recommend the following supplemental report language:

The Department of Information Technology shall adopt a policy requiring that feasibility study report transmittal letters and special project reports address the sensitivity to change of the cost, benefit, and schedule estimates contained in these reports.

Legislature Not Advised of All Major Information Technology Projects

We recommend that the Legislature adopt supplemental report language requiring that the Department of Information Technology adopt a policy requiring departments to (1) provide notification to the Legislature of any feasibility study report approved under delegated authority, where the estimated project cost is \$1 million or more, and (2) provide the Legislature a copy of any special project report issued relating to any project about which it has been notified.

Under current state policy, departments are required to notify the Legislature whenever they transmit an FSR to the DOIT for review. Departments are also required to provide the Legislature copies of any SPR issued relative to a project which has required the review of the DOIT. Although this policy results in the Legislature being notified annually of several major information technology projects, many are not reported because state policy allows the DOIT to delegate to departments the authority to approve their own projects, in which case they are not required to report projects to the Legislature. When the DOIT delegates approval authority, it generally establishes a cost threshold which, if exceeded, requires DOIT review.

Given unresolved problems in the state's information technology infrastructure, we believe that the Legislature should be notified of *all* major projects, and receive the documentation it would normally receive were such projects required to receive the approval of the DOIT. For this reason, we recommend the following supplemental report language:

The Department of Information Technology shall adopt a policy requiring that the Legislature receive notification of any feasibility study report approved under delegated authority, where the estimated project cost is \$1 million or more, and requiring further that the Legislature receive a copy of any special project report issued relating to any project about which it has been notified.

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 [HWDC]). 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 \$85.5 million from the TDC Revolving Fund for support of the center's operations in 1997-98. This is an increase of \$5.6 million, or 7 percent, over estimated current-year expenditures. The primary reason for the increase is the addition of computing capacity to meet customer demand.

Request for Authority To Acquire New Facility Is Premature

We recommend that proposed budget bill language authorizing the Department of General Services to enter into an agreement for a new facility on the data center's behalf be deleted, because the request for authority is premature.

Data Center Wants to Relocate. The TDC has been interested for several years in relocating from its current Sacramento site where it has been situated for approximately 18 years. Reasons cited by the TDC include the potential for flood damage, inadequacies of the current facility, and the need for a better power supply. Several attempts by the data center to secure authority to relocate the facility were not successful, including an effort to secure approval through legislation. Finally, in 1996, the administration agreed to allow the TDC to relocate to a new leased facility under the Department of General Services' (DGS) general authority to enter into leases on behalf of state agencies.

Administration Proposes Lease. The Government Code requires that the DGS notify the Legislature in writing of any proposed lease of five years or longer and costing more than \$10,000 annually. The administra-

tion selected a 20-year lease for the new TDC facility with the ability of the state to terminate the lease after 4.5 years at a lump-sum termination cost of \$24.5 million. By setting the firm term of the lease at 4.5 years, the administration was not required to follow the statutory notification requirement to the Legislature. Nevertheless, the DGS did advise some Members of the Legislature and our office on a verbal basis, of the pending lease.

In response, the Chair of the Joint Legislative Budget Committee (JLBC), wrote the Director of the DGS on July 16, 1996 that "The proposed 4.5-year lease is a blatant disregard for the Legislature's authority for oversight and review of the proposal . . ." and advised the Director of the DGS to not proceed with the proposed lease. The Chair of the JLBC also noted in his letter that the Legislature had appropriated funds in the *1996-97 Budget Act* to examine consolidation of the state's data centers, and that it would therefore be premature to consider any proposal to relocate the TDC until the completion of the study. The consolidation study is required by Chapter 508, Statutes of 1995 (SB 1, Alquist).

On August 16, 1996, the DGS notified the JLBC in writing of its intention to enter into the planned lease, not sooner than 30 days from the receipt of the notification.

Administration Puts Planned Lease on Hold. On September 16, 1996, the Chair of the JLBC responded in writing to the DGS' notification disagreeing with the proposed lease. In his letter, the Chair advised the administration that it should instead complete the data center consolidation study and prepare a plan, consistent with that study, addressing the state's long-term data center needs in the most cost-effective manner. The Chair stated that the plan should be submitted to the Legislature for consideration, preferably through the budget process.

On November 26, 1996, the DGS advised the Chair that it would defer action on the proposed lease pending completion of the consolidation study.

Relocation Is Premature in Absence of Consolidation Plan. The budget bill includes a provision which would authorize the DGS to enter into a lease-purchase, or lease with option to purchase, for a new TDC facility. Based on our analysis, we conclude that relocating the data center is premature in absence of the consolidation report. At the time this analysis was prepared, no such plan has been submitted, and it was not clear when one would be.

Relocation of the Data Center Should Be Supported by an Approved Feasibility Study. We believe that any proposal to relocate the data center should be supported by an approved feasibility study prepared in accor-

dance with the State Administrative Manual (SAM). This should be done because relocating the data center would be a costly and complex endeavor, with service and rate implications for the TDC's customer departments, and with possible budgetary implications as well. Such a feasibility study would describe the problems with the current facility and identify alternative solutions to resolve these problems, along with associated costs and benefits.

Analyst's Recommendation. The Legislature has, through Chapter 508, provided specific direction to the administration to assess the feasibility of consolidating the state's information technology activities, including those conducted by the TDC. Moreover, the Chair of the JLBC has advised the DGS that any proposal to relocate the TDC should follow the completion of the consolidation study to be conducted under the auspices of the DOIT. Furthermore, any relocation proposal should be consistent with a state plan addressing the long-term needs of the data center, and the plan should be reviewed by the Legislature. Because this has not occurred, the proposed authorization is premature. Consequently, we recommend deletion of proposed budget bill language allowing the DGS to enter into a lease on behalf of the TDC.

Legal Expenses Increasing Significantly

We recommend that the data center and the Department of Justice advise the Legislature, at the time of budget hearings, as to the causes of recent substantial increases in legal expenses, the rationale for employing costly outside counsel, and measures taken by the data center to reduce its exposure to litigation.

Increase in Expenditures for Legal Services Has Been Dramatic. In 1992-93 the data center spent \$16,233 for legal services provided by the Department of Justice (DOJ). No funds were expended in that year for external legal service contracts, nor, according to the data center, were any funds expended in 1993-94 or 1994-95 for external services. In 1995-96, however, the data center spent \$101,235 for DOJ services, and also spent \$263,933 for external legal services provided by two private law firms.

In 1996-97, the data center extended through June 30, 1997 the contracts with the two law firms hired in 1995-96, and in addition entered into contracts with two new law firms. The total amount of legal services available through the four contracts in the current year totals \$558,000. The data center also plans to expend approximately \$100,000 each year in the current and budget years for DOJ services. Moreover, the data center advises that in the last three years, the data center has also made expenditures of approximately \$230,000 in the form of settlements and

awards as the result of legal actions taken against the center. Adding these amounts to the expenditures for DOJ services and outside counsel, and amounts the data center anticipates spending for legal services through the end of the current fiscal year, the data center's expenses for legal services, settlements, and awards will total approximately \$875,000 from 1994-95 through 1996-97.

Reasons for Increase Not Fully Known. The TDC has provided only a partial explanation as to why its legal costs have soared in recent years. The data center states that it is unable to provide a complete explanation because the DOJ has advised the TDC that cases in active litigation are considered confidential, and that as a consequence the specific details cannot be discussed.

How Much Is the Data Center Likely to Spend for External Legal Services in the Budget Year? Although the data center advises that it has not budgeted any funds for external legal services for 1997-98, this does not mean that such expenses will not be incurred, because several of the current contracts with outside law firms have been amended more than once to extend the contract period or increase the amount of the contract, or both. For example, a contract with one law firm, which began with an initial contract maximum of \$15,000, has been amended several times to extend the contract term and increase the maximum amount to a current total of \$400,000.

Runup in Legal Expense Is Not Typical of State Data Centers. In the absence of sufficient detail with which to understand the substantial increase in the TDC's legal expenditures, we contacted the HWDC and the DOJ's Hawkins Data Center to determine whether other major data centers have experienced similar recent increases in legal expenditures. We thought this might be possible because data center acquisitions occur often and involve millions of dollars worth of equipment. Legal protests by bidders are not uncommon. However, neither of the two other data centers reported any significant outlays for legal services. The HWDC established a staff counsel position a few years ago, which it has used for contract management and contract negotiation. Consequently, the increased cost of legal services at the TDC does not appear to be related to the nature of managing a major state data center.

Use of External Counsel Is Costly. The DOJ currently charges \$98 per hour for attorney services, and the budget proposes to increase the rate to \$100 per hour effective July 1, 1997. According to information provided by the data center, it will pay from \$130 to \$175 per hour for outside counsel. Therefore, in using outside counsel, it is paying from 30 percent to 75 percent more than the cost of state attorney services provided by the DOJ.

Analyst's Recommendation. The TDC has not provided an adequate explanation as to why its legal expenses have recently become a significant annual expenditure, nor why it must acquire the services of four external law firms in addition to spending \$100,000 annually for services provided by the DOJ. For these reasons, we recommend that the data center and the DOJ advise the Legislature, during budget hearings, as to the reasons for recent substantial increases in legal expenses, the rationale for employing costly outside counsel, and measures taken by the data center to reduce its exposure to litigation.

Money-Losing Service Continues Failing to Break Even

We recommend that \$410,000 be scheduled as a separate reimbursement in order to ensure that the data center recovers the full cost of providing services to clients using the Human Resources Information System. (Reduce Item 2780-001-0683 by \$410,000 and increase reimbursements by the same amount.)

Background. The Human Resources Information System (HRIS) was developed by the TDC to provide leave accounting and other personnel-related services to client agencies. Over the past two years we have expressed concern about the viability of the HRIS, noting consistent annual net losses from this service. In this regard, we noted that the California Leave Accounting System (CLAS), developed by the State Controller and offering some of the same services as the HRIS, is becoming the state's predominant leave-accounting system. In each of the two years when we questioned the viability of the HRIS, the TDC has provided projections showing that anticipated new customers would enable the service to break even. Generally, however, the projections proved optimistic, and HRIS continued to lose money. During budget hearings last year, the TDC committed to charging its customers fees sufficient to ensure that the HRIS breaks even.

Losses Continue Despite Retroactive Adjustments. Information provided by the TDC indicates that as of December 31, 1996 the HRIS was losing about \$180,000 annually. We believe the actual loss could be significantly higher, because in 1996 the data center adjusted the HRIS budget, retroactively deleting personnel costs which had traditionally been charged to its budget. The effect of these adjustments was to reduce the "official" cost to support the HRIS. The data center is projecting a break-even situation based on anticipated expansion of its customer base in 1997; however, the accuracy of past estimates of customer growth does not warrant confidence in the most recent estimates.

Analyst's Recommendation. The data center has been unable to make the HRIS self-supporting. One method of ensuring that the TDC recovers the cost to provide the HRIS service is to designate the cost as a separate reimbursement. However, because of the retroactive adjustments, it is unclear as to the data center's real cost to support the HRIS. We believe that the real cost is likely to be about \$410,000 annually which is the cost identified by the data center prior to its retroactive adjustments. Therefore, we recommend that \$410,000 be scheduled as a separate reimbursement in order to ensure that the data center recovers the full cost of providing services to clients using the HRIS, and that the appropriation be reduced by a like amount.

Mainframe Capacity Upgrade Requirements May Be Overstated

We withhold recommendation on \$4.9 million requested to increase mainframe computing capacity and electronic storage media, pending a determination as to the likelihood that anticipated workload necessitating the upgrade will materialize.

The proposed budget includes \$4.6 million to upgrade mainframe computing systems and \$325,000 to increase the capacity of disk storage systems in order to meet anticipated increases in customer workload. Budget documents provided by the data center indicate that a significant portion of the anticipated workload will come from a Board of Equalization (BOE) project—the Integrated Revenue Information System (IRIS).

The data center's budget assumes that the IRIS project will require additional mainframe and disk storage capacities in the budget year; however, the BOE has been engaged in a dispute with the contractor hired to develop and implement the IRIS, and the project schedule has been pushed back as a result. Based on discussions with BOE managers, we believe it is possible that the project could slip even further, going beyond the current target date of January 1, 1998 for completing the project.

The BOE and the contractor are involved in an effort to resolve their differences. Thus, it is possible that a firm schedule will be developed between now and the time the budget is heard. Therefore, we withhold recommendation on \$4.9 million requested to increase mainframe computing capacity and electronic storage media pending a determination as to the likelihood that anticipated workload necessitating the upgrade will materialize.

Telecommunications Augmentation Appears Overstated

We withhold recommendation on \$2.5 million and two positions requested to increase telecommunications services pending the data center's redetermination of its budget requirements based on likely workload requirements from customer departments.

The data center is requesting \$2.5 million and two positions to increase its telecommunications service capabilities in order to satisfy increased demand from its customer departments. According to the data center, an electronic commerce pilot project managed by the Department of General Services (DGS) is one of the significant components of the anticipated workload upon which this budget request is based. The data center's budget assumes that the DGS pilot project workload will have to be accommodated by July 1, 1997. The DGS, however, advises that it has not provided the data center with a firm date for when the project will require TDC resources, but had targeted the fourth quarter of 1997. This target date is subject to change because the DGS project has experienced delay from the schedule identified in its feasibility study report, and as of January 1997, did not have an updated schedule.

For these reasons, we withhold recommendation on \$2.5 million requested to increase telecommunications services capacity pending the data center's redetermination of its budget requirements based on its likely workload requirements from customer departments.

Justification for Disaster Recovery Augmentation Unclear

We withhold recommendation on \$500,000 requested to augment the data center's budget for disaster recovery services provided by a private firm pending the resolution of discrepancies among budget-related documents provided by the data center to support the augmentation.

The data center has for several years maintained a contract with a private sector firm to provide backup services to the data center in the event a disaster affected the ability of the TDC to process critical state computer applications. The backup facility is located in another state, and the data center and those customer departments using the service periodically test the backup system to ensure that it will operate properly in the event of a disaster.

The data center is requesting an additional \$500,000 to: (1) accommodate anticipated new workload from various customer departments, (2) contract for personnel to backup TDC personnel who may be unable

to travel to the remote backup facility in the event of a disaster, and (3) acquire consulting services to help TDC customers plan for operational recovery in the event critical information systems become inoperable due to a disaster. The budget documents do not provide a sufficient breakdown of the costs associated with these factors, however, and supporting information provided by the data center conflicts with the original budget documents. As a result, we withhold recommendation on the requested \$500,000 pending the resolution of discrepancies among budget-related documents provided by the data center to support the augmentation.

Technical Budgeting Issues

We recommend a reduction of \$520,000 due to overbudgeting. (Reduce Item 2780-001-0683 by \$520,000).

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 \$520,000, are as follows:

- \$210,000 because the data center has understated the amount which will be likely saved as the result of budgeted positions not being filled for a full 12 months (increase salary savings \$210,000).
- \$310,000 budgeted for general expenses and out-of-state travel expenditures, because the data center could provide no basis on which to support the budgeted amount (reduce general expenses \$270,000, and reduce out-of-state travel \$40,000).



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 operations is reimbursed fully by its clients.

The budget proposes \$208 million for support of the center's operations in 1997-98, which is a decrease of \$81.8 million, or 28 percent, below estimated current-year expenditures. The reduction results primarily from payments made in the current year to contractors for work completed on major information technology projects being managed by the HWDC on behalf of the Department of Social Services (DSS).

Cost Increase for the Statewide Automated Welfare System

We withhold recommendation on \$12.6 million budgeted to support expansion of the Statewide Automated Welfare System pending further review of documentation supporting the budget.

Background. The data center's budget includes \$55.4 million to continue support for the Statewide Automated Welfare System (SAWS). The purpose of SAWS is to provide improved and uniform information technology capability to county welfare operations, through a state partnership with four consortia comprised of the 58 counties in the state. The four consortia were authorized by the Legislature in the *1995-96 Budget Act*. They are comprised of the:

- Interim Statewide Automated Welfare System (ISAWS).
 - Los Angeles Eligibility Automated Determination, Evaluation and Reporting System (LEADER).
-

- Welfare Case Data System (WCDS) Consortium.
- Consortium IV (C-IV).

Implementation Status. The ISAWS project, being managed by the HWDC, is currently operational in 18 counties, and will, when completed in 1998, encompass a total of 35 counties, primarily small caseload counties. The LEADER system is being implemented by Los Angeles County and is currently under development. The WCDS Consortium, consisting of 18 counties, and the C-IV Consortium, consisting of four counties, are in the planning phase. According to the HWDC, a request for proposal to secure a contractor to develop and implement a solution for the WCDS Consortium was anticipated to be delivered in late January 1997 to state and federal authorities for their review. According to recent planning documents, the WCDS Consortium is requesting approval of its project at a total multiyear cost of \$278 million for development and implementation. The C-IV Consortium has requested approval of \$3.1 million for just the planning phase. The HWDC budget includes \$12.6 million for support of the WCDS and C-IV Consortium projects in 1997-98.

Recent Changes to Project Cost Estimates. The HWDC is requesting an additional \$14.4 million in 1997-98 for the SAWS project. The data center maintains that some of the cost increases do not reflect a cost overrun, but reflect instead the normal progression of the project from one phase to another. Other increases, however, appear to be the result of insufficient allowances made for normal project activities, such as making necessary changes to computer programs to meet the needs of the counties. After the budget was submitted, the HWDC provided information revising previous cost information for specific project activities. At the time this analysis was prepared, we had not been able to fully review this revision. We believe that further review of the justification for the proposed \$14.4 million budget increase is warranted based on unresolved questions about budget details and the recent revised cost estimates.

Impact of Welfare Reform on System Requirements. Of the four consortia authorized by the Legislature, two (LEADER AND ISAWS) are already in the process of implementing specific systems based on requirements which were established prior to August 1996 when Congress and the President enacted federal welfare reform. As noted in our recent policy brief, *Welfare Reform in California: A Welfare-to-Work Approach*, welfare reform is one of the most important policy issues facing the Legislature and Governor this year. And, we note that welfare reform can be implemented through many different models. Until the Legislature and the administration agree on a specific model, the specifications for the information systems to be developed for the WCDS and C-IV consortia cannot be fully defined. Consequently, we believe that the administration

may have to reconsider its plans for these two consortia in order to avoid subsequent costly retrofitting of systems.

Analyst's Recommendation. Of the \$55.4 million budgeted for SAWS, \$12.6 million will be allocated for expansion of the projects in the budget year, including consortia planning, management and development, and reprogramming of SAWS. Consequently, we withhold recommendation on these proposed funds for expansion, pending further review of documentation supporting the budget.

Continued Implementation Difficulties For Child Support System

We withhold recommendation on \$37.9 million budgeted to continue implementation of the Statewide Automated Child Support System, pending the receipt and review of a special project report detailing project changes needed to address continued system performance problems. These changes may impact the project's budget requirements for 1997-98.

Background. The Statewide Automated Child Support System (SACSS) is a federal and state-mandated computer-based system to provide a statewide child support enforcement tracking and monitoring capability through the offices of county district attorneys. In 1995, the administration transferred the responsibility to manage this project from the DSS to the HWDC in order to resolve serious implementation problems. The proposed budget includes \$37.9 million to continue project development in 1997-98, including an increase of \$11.1 million.

Project Remains on a Costly Rocky Road. The ten-year project cost of the SACSS was estimated to be \$152 million when the Legislature approved the budget for 1995-96. It was reestimated at \$260 million after the HWDC assumed responsibility for the project, and reestimated again at \$313 million in a January 1997 special project report (SPR). Some of the project's increased costs have resulted from including related costs which were planned but not included in earlier estimates; for example, the cost to the DSS for the centralized distribution of child support collection information to custodial parents. Other increases are the result of the renegotiation of the original contract and normal system development activities which should have been included in previous estimates but were not. It now appears that the project is facing the potential for even more increases in cost and further schedule delays as the result of performance problems in counties where the new system has been installed (22 counties were operating with SACSS as of December 31, 1996).

At the time the HWDC was given responsibility for management of the SACSS project, the project was essentially at a stalemate between the state

and the contractor hired to design and implement the system. Under HWDC management, the contract was renegotiated and progress was made in renewing project development and ultimately installing the new system in several counties, generally ones with small caseloads and limited information technology capability.

As reported in last year's *Analysis*, serious problems were encountered when the state attempted to install SACSS in Fresno County, which has a medium-sized caseload and is a relatively sophisticated user of information technology. These problems forced a reassessment of the project, which resulted in the need to alter schedules. Now, one year later, SACSS has yet to perform satisfactorily in Fresno County. Other counties where SACSS has been installed have also experienced problems. Consequently, the project is undergoing another assessment. According to the HWDC, an SPR will be submitted to the administration and the Legislature no later than the first week of March 1997.

Will the Federal Government Again Extend the Deadline for System Completion? The federal government has provided funding for 90 percent of the SACSS implementation cost. Last year, the federal government extended this enhanced funding level until October 1, 1997, at which time the funding level will drop to 66 percent. According to the HWDC, it and the DSS plan to meet with federal representatives in Washington D.C. in early February 1997 to discuss further extension of enhanced federal funding of the project. The HWDC further advises that many other states concerned with meeting the October 1997 deadline have also questioned the federal government regarding the possibility of another extension of the higher federal funding. If federal financial participation for implementation costs reverts to 66 percent in October 1997, and state implementation goes beyond this date, then the state would incur additional costs of \$3 million in 1997-98, based on the Governor's budget.

Analyst's Recommendation. The estimated cost of SACSS has increased more than *100 percent* from the amount approved by the Legislature when it enacted the budget for 1995-96, including a 30 percent increase in the past year alone. The extent to which continued serious problems with system performance will affect budget requirements for the SACSS project will not be known by the HWDC until this spring.

For these reasons, we withhold recommendation on \$37.9 million budgeted to continue implementation of the SACSS, pending the receipt and review of an SPR detailing project changes needed to address continued system performance problems.

Implementation Expenditures For Child Welfare System Not Justified

We recommend a reduction of \$10 million for support of the Child Welfare Services Case Management System, to eliminate expenditures which should more appropriately be assumed by counties or for which inadequate justification has been provided. (Reduce Item 4130-001-0632 by \$10 million.)

Background. Chapter 1294, Statutes of 1989 (SB 370, Presley), requires the implementation of a single statewide Child Welfare Services Case Management System (CWS/CMS). The primary goal of this system is to provide a statewide database, case management tools, and reporting system for the child welfare services program. By 1995, the project was in serious trouble, with counties balking at acceptance of the detailed system design. In April 1995, the administration transferred responsibility for project management from the DSS to the HWDC in an effort to improve the project's prospects for success. The HWDC's proposed budget includes \$24.8 million to continue support of the CWS/CMS project in 1997-98.

Proposed Upgrade of Software Provides No Benefit to State. The Governor's budget proposes to transfer to county ownership 5,549 personal computers and 488 printers which were (or will have been) acquired by the state for the CWS/CMS project, and which are currently owned by the state. The HWDC is proposing the transfer of ownership based on several factors. The key rationale, according to budget documents, is that doing so is consistent with the Governor's initiative to make government more competitive by not hiring additional state staff. According to the administration, transferring ownership of the personal computers will avoid the need to hire an additional state position to manage the equipment inventory, thereby realizing an annual cost avoidance of \$84,000.

In addition to transferring the personal computers to the counties, the HWDC is proposing to spend \$2 million in the current year and \$5 million in 1997-98 to upgrade the software on these same personal computers. According to information provided by the data center, this upgrade is not required in order to make CWS/CMS operate properly. The CWS/CMS is performing in counties according to system specifications, using the personal computer software the HWDC is proposing to replace. Our analysis indicates that while the current software will eventually need to be upgraded, there is no operational need to do so now.

Inadequate Justification for Amount Requested for System Changes. The budget also includes \$5 million to make unspecified changes and

upgrades to the CWS/CMS. The HWDC cites "industry standards" as support for an annual investment in system changes of up to 20 percent of the cost of developing a system. According to information provided by the HWDC, \$5 million represents about 10 percent of the cost to develop the CWS/CMS.

According to the HWDC, the CWS/CMS performs in accordance with specifications approved by the counties, and would continue to be maintained to perform properly even if this funding request were not approved. According to the HWDC, the counties now want changes to make the system *easier* for them to use, and the HWDC believes that it is essential to keep counties satisfied with the CWS/CMS in order to avoid failure. However, the HWDC was unable to provide an example of an instance where a properly maintained system, which performed according to approved specifications, nevertheless failed.

Analyst's Recommendation. Approval of the request to expend \$5 million in the budget year to upgrade personal computer software would have little or no benefit to the state and is not necessary to enable CWS/CMS to function properly. Similarly, a request for \$5 million to make unspecified system changes is not justified based on a lack of information provided by the HWDC. Consequently, we recommend a reduction of \$10 million out of \$24.8 million proposed in the budget for local assistance for the CWS/CMS.

Funding for Fingerprint Imaging System Should Await Completion of Report

We recommend that \$6 million budgeted for acquisition and operation of a Statewide Fingerprint Imaging System be deleted from the budget, and that authorization for expenditure of up to an equivalent amount be placed in a separate provision of the budget bill, because a required feasibility study report has not been completed, and the cost of acquisition and operation of the new system will not be determined until a bid has been awarded.

Background. The 1995-96 Budget Act assigned to the HWDC the responsibility for implementing the Statewide Fingerprint Imaging System (SFIS). The system, modeled after one implemented in Los Angeles County in 1994, is intended to reduce the cost of fraud associated with state welfare programs. The HWDC budget documents indicate that, based on estimates of annual savings in Los Angeles County of \$32 million, substantial savings would be realized if a statewide system was in place in all 58 counties. The budget includes \$6 million in 1997-98 to implement the SFIS.

Schedules for Information Technology Projects Tend to Slip. State policy requires the development and approval of a feasibility study report (FSR) before an information technology project can proceed. Cost, schedule, and benefit estimates are key components of an FSR. These estimates are often refined as a result of bids submitted by interested contractors. Consequently, a proposed project's cost, benefits and schedule are corroborated only when a contract is awarded. Thus, the current estimates must be considered as tentative when made prior to a contract award.

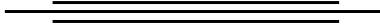
The data center's schedule for SFIS indicates that an FSR will be provided to the Department of Finance and the Department of Information Technology in April 1997. Contract award, to be made based on a competitive process, is scheduled to occur in June 1997. Full system operation is slated to occur in July 1998.

It is not unusual for information technology project schedules to undergo frequent extensions. In fact, three of the four major projects discussed in this review of the HWDC have all experienced schedule delays, including the SFIS. Project delays frequently result because of the procurement process, which can experience setbacks for various reasons including protests filed by competing bidders. These delays are important because they often result in added costs.

Analyst's Recommendation. We believe that the Legislature does not have sufficient information about this project to warrant approving the funds which have been requested, given that (1) the FSR has neither been completed nor approved; (2) cost, benefits, and schedule for implementing the SFIS will not be known until a bid is awarded; and (3) further schedule slippage is not unlikely. However, the project has been a high priority for both the Legislature and the administration, and could result in substantial statewide welfare savings costs. For these reasons, we believe that the budget should provide a means to fund continuation of the project once funding requirements can be confirmed. Placing funding authority in a separate provision of the budget bill will help to ensure that expenditures for the SFIS will be based on better estimates than are now available. Therefore, we recommend that \$6 million budgeted for acquisition and operation of the SFIS be deleted from the budget, and that authorization for expenditure of up to an equivalent amount be placed in a separate provision of the budget bill. Adopting this recommendation will not delay the project, but rather ensure that it goes forward after the FSR is completed and the cost of acquisition and operation of the new system is determined once a bid has been awarded.

Specifically, we recommend that the Legislature adopt the following budget bill language:

In augmentation of the funds appropriated by this item, an additional sum up to \$6 million is hereby appropriated for continued development and implementation of the Statewide Fingerprint Imaging System (SFIS), subject to the review and approval of the Department of Finance and the Department of Information Technology of a feasibility study report prepared in accordance with the State Administrative Manual, and the award of a contract for implementation of the SFIS. In the event that a contract award is not made prior to July 1, 1997, the funds appropriated by this subdivision shall be made available consistent with the amount approved by the Department of Finance based on its review of the feasibility study report. In the event that a feasibility study report is not approved prior to July 1, 1997, the funds appropriated in this subdivision shall be made available by the Department of Finance in an amount sufficient to ensure completion of a feasibility study report, and in an amount consistent with a subsequent contract award.



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 and hazard mitigation.

The budget proposes \$567 million in total expenditures in 1997-98. This is an increase of \$4.1 million, or less than one percent, over estimated current-year expenditures. The budget does not include funds to pay for state expenses and local assistance arising from the recent statewide floods.

Support Budget. Of the OES' total \$567 million budget, \$75.7 million is for direct support of the office. This includes \$29.6 million from the General Fund, \$38.1 million from federal funds, and the remainder (\$8 million) from various other funds and reimbursements. The amount proposed for support is \$2.1 million, or 2.7 percent, less than estimated current-year expenditures.

Local Assistance Budget. In addition to support costs, the budget includes \$492 million for local assistance to pay claims from previous disasters. This is \$6.2 million, or 1.3 percent, more than estimated current-year expenditures for local assistance. The proposed local assistance expenditures for the budget year include \$420 million from federal funds, \$59.2 million from the General Fund, \$10.2 million from the Disaster Relief Fund, and \$1.8 million from the Nuclear Planning Assessment Special Account.

Proposed Budget Should Be Viewed As Very Rough Estimate

The proposed budget will have to be adjusted to reflect costs associated with the recent statewide floods.

For a number of reasons, OES' annual budget proposal, and the amounts subsequently approved by the Legislature, have often borne

little resemblance to actual expenditures. This has generally occurred as the result of unanticipated disasters resulting in increased costs. Other factors include the rate at which claims for disaster recovery funds submitted by local government agencies are processed by the OES and the Federal Emergency Management Agency (FEMA).

The budget does not include funds to pay for the January floods and related damage. Thus, OES' funding needs for the current and budget years will likely be substantially revised by the administration. Thus, the level of funding requested for the OES should be viewed as a very rough estimate which may bear little resemblance to what the OES will actually spend in 1997-98.

Failure to Provide Legislature Expenditure Information

The Office of Emergency Services has failed to respond to the Legislature's request for periodic information regarding the payment of disaster recovery claims to local agencies.

In an effort to obtain better financial information from the OES, the Legislature adopted supplemental report language in 1996 requiring the OES to provide the Legislature with the office's plan for expending the amounts appropriated for payment of local disaster relief claims. This plan was due to the Legislature within 90 days of the enactment of the *1996-97 Budget Act*. The plan is required to identify the specific projects for which claims are anticipated to be paid in the current year. In addition, OES was required to report quarterly on its progress toward fulfilling its expenditure plan, updating the plan as necessary, and explaining significant changes reflected in the updated plan.

To date, OES has failed to provide either the original or the required quarterly reports. Consequently, the Legislature has not received the information it had sought in order to obtain a better understanding as to how funds it appropriates for local assistance are actually paid out.

Improvements in Departmental Performance Are Slow

The ability of the Office of Emergency Services (OES) to effectively carry out its disaster recovery and hazard mitigation responsibilities continues to be hampered by internal shortcomings. The Legislature should consider whether these functions ought to be transferred to another state agency or whether there should be a wider reorganization of the OES.

Background. The Legislature adopted supplemental report language in 1995 requiring that the Bureau of State Audits (BSA) conduct a comprehensive fiscal and performance audit of the OES. The purpose of the audit was to develop recommendations which, if implemented, would 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 report, issued in January 1996, found that while the OES met most of its emergency coordination responsibilities, it did so in the face of serious administrative problems. According to the BSA, inefficient administrative practices had resulted in an "administrative crisis" in which the OES used more resources than necessary and therefore incurred additional state costs. The audit report recommended specific actions to address and resolve the administrative problems identified in the report, and the OES committed to implementing the recommendations.

Despite efforts by the OES to improve its administrative operations, legislative concern with the manner in which the OES was managing certain operations resulted in the adoption of budget act language in 1996 requiring another audit by the BSA. The new audit was to examine the disaster claims processing and hazard mitigation grant programs managed by the OES. Specifically, the BSA was asked to (1) identify specific opportunities for improving these programs in order to develop a more efficient, cost-effective, and equitable process for resolving claims and grant applications; and (2) assess whether the claims processing and hazard mitigation grant operations of the OES can be best performed by OES, another state agency, contracted out, or whether claimants and grant applicants should deal directly with the FEMA.

Audit Findings. The BSA released its second audit report on January 30, 1997, finding that OES' effectiveness continues to be hampered by shortcomings in managing its disaster recovery efforts. These shortcomings include:

- Not balancing management attention and resource commitments to OES' varied responsibilities, thereby negatively affecting recovery from past disasters.
 - A lack of adequate planning for many functions central to recovery efforts.
 - Performing activities which exceeded OES' administrative responsibilities, thereby resulting in added annual costs of at least \$800,000.
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- The BSA recommended that the claims processing and hazard mitigation grant programs remain with the OES. The audit report however, did not fully address whether these operations could be performed more effectively by placing them with another state agency or contracting them out. As a result, we believe that the question is still open as to whether moving the claims processing and hazard mitigation grant operations to another entity would improve these operations.

Lack of Progress in Applying Information Technology Is Troubling. The BSA also found that the OES was falling behind in implementing key information technology initiatives designed to improve its operations. For example, it is generally acknowledged that OES' difficulties in the claims processing area are due to operating a manual document processing system. Yet, according to the BSA, the OES is at least 15 months behind in its schedule to create an automated system for handling the large volume of documents generated by the disaster assistance and hazard mitigation grant programs. The OES does not expect to complete the system until 2001. The audit report also notes that an OES effort to automate its management of damage survey reports—the reports on which claims are based—was abandoned after the new system in which the OES had invested over \$5 million failed to operate properly. Although the OES is attempting to salvage portions of the system which it abandoned, the BSA notes that, of the seven short-term information technology projects scheduled for completion in 1996, two were finished on time, two were late, and three remain to be completed.

The OES Was Unable to Provide Information as to its Progress in Reducing the Claims Backlog. In reviewing the budget proposal, we asked the OES to provide data indicating its progress in resolving the backlog of claims from local governments for payments related to various disasters. We made this request in mid-January. At the time this *Analysis* was prepared at the end of January, the OES advised us that it was in the process of developing the information requested. We believe that the inability of the office to respond to a relatively short period of time to a request for such basic information illustrates the problem the OES is experiencing in managing its nonemergency operations.

What Should the Legislature Do? The Legislature has in recent years attempted to provide additional policy direction to the OES in order to make it a more effective organization, as well as to respond to the legitimate informational needs of the Legislature. So far, the results have been mixed. Although the OES has committed to implementing recommendations made by the BSA, significant progress in improving the office's administrative operations has been slow. Similarly, various legislative requests for information concerning disasters, including payments, have

not been responded to adequately. This puts the Legislature in an awkward position, because the programs the OES administers are essential. At the same time, the persistence of administrative problems in the OES, as noted by the BSA, results in the inefficient use of resources, and thereby added state cost. Moreover, these problems affect local agencies which must rely on the OES in order to receive disaster assistance funds to which they are entitled.

Given the difficulty the OES is having in terms of resolving its administrative difficulties, we believe that the Legislature was on the right track when it directed the recent audit to determine whether two key administrative operations—claims processing and hazard mitigation grants—should remain at the OES or be placed elsewhere in order to operate more effectively. As noted above, we believe that the BSA’s report leaves the question unanswered. Consequently, the Legislature could make its own determination to move these operations to a state entity or a contracting agent which has demonstrated the ability to apply information technology effectively to claims processing functions. In the same vein, the Legislature may wish to consider a wider reorganization of the OES, in order to allow it to focus on what it does best—coordinating the state’s response to emergencies—and divest it of nonemergency operations which it does not perform well or which are not essential to its core responsibility.

Expenditures for Specific Disasters Should Be Highlighted In the Governor’s Budget Document

We recommend that the Legislature adopt supplemental report language directing the Department of Finance to separately schedule in the Governor’s budget document local assistance expenditures for each declared disaster for each of the three fiscal years.

As discussed above, the Legislature’s efforts to obtain better information concerning disaster expenditures from the OES have been generally unsuccessful. It is not clear when this situation will be resolved. We believe that one way to move the OES in the direction of satisfying the Legislature’s needs is to separately identify in the Governor’s budget document the local assistance expenditures for each declared disaster for each of the three years. Currently, other than for the 1989 Loma Prieta earthquake, there is no way to discern from the Governor’s budget document or the budget bill just how the OES anticipates allocating its annual local assistance budget. Yet, in developing its annual budget request, the OES must anticipate the amounts it will likely pay out for the disasters for which claims are still being processed.

Placing this information in the annual Governor's budget document should provide the Legislature a much better understanding as to how the administration intends to spend the local assistance funds, recognizing that actual expenditures for a specific disaster may change for a variety of reasons. By listing each open disaster separately for each of the three fiscal years listed in the Governor's Budget, the Legislature will be better able to understand the basis for the annual budget request, and its reliability. Such a display may also have the additional benefit of encouraging the OES to refine its estimates to make them as reliable as possible.

Analyst's Recommendation. For these reasons, we recommend that the Legislature adopt supplemental report language directing the DOF to display budgeted expenditures for local assistance separately in the Governor's budget document for each declared disaster for each of the three fiscal years displayed in that document.

Specifically, we recommend the following supplemental report language:

In the 1998-99 Governor's Budget for the Office of Emergency Services, the Department of Finance shall display expenditures for local assistance for each declared disaster for each of the three fiscal years included in the budget document.

Hazard Mitigation: Recommendations Are Numerous, But Follow-Through Is Minimal

The Office of Emergency Services is not adequately tracking the implementation status of numerous recommendations made over the years as the result of post-disaster assessments.

After each major disaster, the OES, in cooperation with the FEMA and local emergency management agencies, produces a report containing specific recommendations intended to mitigate the effects of future disasters. The reports are very detailed and considerable effort goes into their preparation. Most recommendations identify an agency responsible for overseeing implementation of the recommendation, and include an estimate of cost and an indication as to when the recommendation should be implemented.

Given the repetitive nature of natural disasters in California, these reports are viewed as important by OES, FEMA, and local agencies, because they describe what measures ought to be taken in order to reduce the damage from a subsequent disaster. Despite the importance attached to these reports, the OES does not have a system in place to track their implementation status. In the meantime, local emergency management agencies we have talked to are often at a loss to tell whether a recommen-

dation important to them has been implemented. The OES advises that it intends to develop such a capability, but it is not clear as to when that might occur, particularly given difficulties OES is experiencing in developing information technology applications.

Where Should New Training Program Be Placed?

We withhold recommendation on \$481,000 requested to establish a centralized training facility for an urban search and rescue program, pending the receipt of information from the Office of Emergency Services (OES) explaining the need for this program, why it should be managed by the OES, and why it is not proposed to be located at the OES' California Specialized Training Institute.

The budget requests \$481,000 from the General Fund to establish a new state training facility at McClellan Air Force Base in Sacramento to consolidate local, regional, and state urban search and rescue programs. This proposal would also provide a support system for disaster K-9 teams. According to the OES, this training facility is needed to help complete the California Urban Search and Rescue Program, which was implemented in 1990.

We have the following concerns with this proposal.

First, information submitted in support of the proposal does not make a case for this new training program. Specifically, it does not indicate what, if any, problem exists with the state's current urban search and rescue capability. For example, no evidence is provided to demonstrate that the lack of the training facility has hampered urban search and rescue efforts. It is also not clear why the state would implement a program in 1990 and then wait until 1997 to propose funding one of its key components. Moreover, the OES has not made it clear as to why it should create a new training facility, as opposed to assigning this training to existing state training programs, for example, those conducted by the State Fire Marshal in the California Department of Forestry and Fire Protection (CDFFP).

We also question why this function should be placed within the OES. As discussed above, we believe there is merit in removing certain functions from the OES that can be accomplished elsewhere. This would permit the OES to focus its efforts on the coordination of the state's response to emergencies. Finally, we question why the OES would place the training program in the Sacramento area, when it has for years operated the California Specialized Training Institute near San Luis Obispo. The San Luis Obispo training facility provides a variety of emergency-related

training to various governmental jurisdictions throughout the state and other jurisdictions.

Analyst's Recommendation. For all these reasons, we withhold recommendation on the \$481,000 requested to establish a centralized training facility for an urban search and rescue program, pending the receipt of information from the OES explaining the need for the program, why it should be managed by the OES, and why it is not located at the California Specialized Training Institute which the OES operates near San Luis Obispo.

Should the OES Manage Fire Engines?

We withhold recommendation on \$277,000 requested to upgrade firefighting equipment, pending receipt of a report to the Legislature from the Office of Emergency Services (OES) and the California Department of Forestry and Fire Protection (CDFFP) on how the OES firefighting program can be merged with the CDFFP.

The budget includes \$277,000 from the General Fund to upgrade old fire fighting engines so that they can accommodate foam fire retardant, and purchase communications and safety equipment associated with their operation. According to the OES, the original mission of its fire engines was for civil defense firefighting. Since then, the mission has expanded to include activities such as emergency medical response and "flood fighting." The OES currently owns a fleet of 109 fire engines which are assigned to local government fire agencies who operate them with their own employees.

It is not clear why the management of these fire engines should remain with the OES, as doing so only perpetuates a fragmented approach to the state's management of firefighting equipment. We believe that a case can be made for transferring the responsibility for managing these engines, and the associated support resources, to the CDFFP, which already manages in excess of 1,000 fire engines. Doing so would not only consolidate fire engine management in one department, which should be cost beneficial, but it would be consistent with the objective of removing from the OES those administrative operations that can be performed as well or better elsewhere.

For this reason, we withhold recommendation on \$277,000 requested to upgrade firefighting equipment, pending receipt of a report to the Legislature from the OES and CDFFP, prior to budget hearings, on how the OES' firefighting program could be merged with the CDFFP.

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 laws. 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 \$103 million (\$62.1 million from the General Fund) to support the activities of the State Controller in 1997-98. This amount is virtually the same level as estimated current-year expenditures.

Performance Audit Progress Report

The State Controller's report to the Legislature on the results of implementing recommendations of a performance audit leaves important questions unanswered.

Background. In early 1995 the Controller ordered a performance audit of the operations of the State Controller's Office. The audit, conducted by a consulting firm, resulted in a May 1995 report which contained many specific findings and made recommendations to improve the office's operations. These recommendations identified opportunities to achieve savings, and also noted where increased expenditures would be required in order to avoid failures in certain critical program areas. Since the report has been issued, the Controller has requested, and the Legislature has approved, reductions in the Controller's budget consistent with those identified in the audit report (\$8.8 million and 104 positions as of June 30, 1996, according to the Controller).

We raised several questions in last year's *Analysis* as to whether certain of the reductions would improve the operations of the office. In order to

obtain a better understanding of how these reductions affected the operations of the State Controller, the Legislature adopted language in the *1996-97 Budget Act* requiring a report from the Controller on performance results, including a historical analysis of expenditures and program output and an assessment of the office's performance as measured against specific performance measures.

Report Leaves Important Questions Unanswered. The report issued by the Controller on January 15, 1997 offers little in the way of a historical analysis of expenditures and program output, because it provides data for only 1995-96. According to the Controller's Office, 1995-96 was used as the base year because there were insufficient historical data to provide meaningful comparisons for previous years. Nevertheless, it is not possible for the Legislature to determine from the report, for example, the effect of position reductions on the office's ability to generate revenue through specific audit activities or carry out other aspects of its statutory mission. This is the kind of information the Legislature sought when it adopted the budget control language. Similarly, while the office has developed an extensive number of performance measures, many of the performance objectives and measures provide limited information. For example, a number of objectives are in the category of accelerating the processing of various tasks, but do not address the equally important issue of quality. Some measures do not really relate to performance of the Controller's Office (for example, those related to services provided by the Stephen P. Teale Data Center). Other measures do not provide the Legislature with useful information to assess how well the Controller's Office is performing. As an example, one performance objective is to improve client relationships by ensuring that audit reports are issued in a timely manner and provide value to the auditee. However, the performance measure focuses on timeliness and does not address the question of value to an auditee.

Conclusion. Based on our analysis, we believe that the Controller should review these performance objectives and measures with the purpose of improving them so that periodic assessments of performance, whether reported internally or shared with the Legislature, facilitate an understanding of the office's performance. Moreover, as the report has not addressed aspects of the Legislature's directive as stated in the *1996-97 Budget Act*, the Legislature may wish to discuss this issue during budget hearings.

When Will Information Technology Improvements Be Made?

We recommend that the Controller and the Department of Finance submit a plan to the fiscal committees, prior to budget hearings, that

specifies how and when critical information technology requirements cited in the Controller's 1995 performance audit will be met. The plan should include an assessment of the resources necessary to meet these requirements in the budget year and how the resources will be provided, such as through redirection of existing resources or budget augmentation.

Audit Report Emphasizes Need for Major Information Technology Investments. The May 1995 performance audit ordered by the Controller found that the office was faced with having to invest as much as \$100 million over several years to replace "mission-critical" information systems. The audit noted that failure to make the investment would expose certain of the systems maintained by the Controller to an "extreme risk of failure." Specifically, the audit found that the state's fiscal, payroll and accounting systems are obsolete, difficult to maintain and in need of replacement. Also, the audit cited the need to modify computer programs in order to accommodate the Year 2000 change, a problem facing virtually all state agencies. (We discuss this issue from a statewide perspective in our analysis of the Department of Information Technology earlier in this chapter.) In addition to replacing mission-critical systems at a cost of up to \$100 million, the audit also identified the need for the Controller to invest up to \$3.5 million to upgrade personal computers and associated equipment, and \$2.6 million annually for various other information technology needs.

Budget Does Not Address Information Technology Needs. According to the performance audit, upgrading the Controller's information technology systems cannot be deferred indefinitely. Indeed, the audit stresses that addressing the significant problems and opportunities identified by the audit will require major "up front" investments. Discussions of this situation with staff of the Controller's Office confirm that while some progress has been made toward addressing the problems outlined in the performance audit, additional resources should be allocated in 1997-98 in order to ensure that these critical information technology needs are addressed in a timely manner. However, the proposed budget identifies no funding for this purpose. Nevertheless, the performance audit progress report issued on January 15, 1997 indicates that current activity regarding these major needs is in the planning stage; however, it is not clear from the report when specific plans will be completed, nor is there any discussion of the need for major technology investments within a specific time frame.

Analyst's Recommendation. In view of the above, we recommend that the Controller and the Department of Finance (DOF) submit a plan to the fiscal committees prior to budget hearings outlining how and when critical information technology needs cited in the performance audit will be met. Specifically, the plan should include an assessment of the re-

sources necessary in the budget year to meet the critical needs and how the resources will be provided, such as through redirection of existing resources or budget augmentation. To the extent that the plan calls for redirecting resources, it should identify the programs the resources would be redirected from, as well as the impact of proposed redirections on existing programs.

Backlog of Notifications To Owners of Unclaimed Property

We recommend deletion of proposed budget bill language which would unduly limit the State Controller's ability to process the backlog of notifications intended to locate the owners of unclaimed property held by the state.

Background. Since 1959, banks and other institutions have been required by law to remit unclaimed property to the state. Examples of such property include bank accounts, safe deposit box contents, stocks and the proceeds of insurance policies. Property is deemed to be unclaimed when an account has remained dormant for three years and efforts by the institution holding the account to locate the owner have been unsuccessful. The unclaimed property is then transmitted to the State Controller, who maintains records of all receipts and their value and attempts to identify the owners of the property. Because the state is essentially holding unclaimed property in trust until a legal owner is identified, a portion of unclaimed property funds is returned annually to claimants. If a legal owner is not identified, the state assumes ownership of the property.

According to the Controller's Office, the state currently holds in excess of \$2 billion in unclaimed property belonging to approximately five million individuals and organizations. Annually, the state receives in the range of \$250 million to \$300 million to hold pending efforts by the Controller to locate the owners. Annually, about \$80 million is paid out to approximately 65,000 claimants. The *1997-98 Governor's Budget* assumes that the state General Fund will receive net revenues of \$165 million from unclaimed property in 1997-98.

Proposed Budget Restores Cap on Notification Expenses Which Legislature Had Removed. The Controller is required by law to take steps to locate and notify apparent owners of unclaimed property. The notifications, which are required within prescribed time frames, must be made in the form of publication in a general circulation newspaper and a mailed notice when there is an apparent owner. Beginning in 1992-93, the amount the Controller could spend on mailed notices was limited by the annual budget act to \$35,000, an amount which allowed the Controller to mail 106,000 notices. This cap was removed when the Legislature passed

the *1996-97 Budget Bill*. However, the *1997-98 Budget Bill* would restore the \$35,000 cap. It is our understanding that this cap was reinstated because of a difference of opinion between DOF and the Controller as to how much should be budgeted for purposes of complying with the legal requirement to make timely notification and process claims.

Limitation Unduly Restricts Controller From Locating Rightful Owners of Property and Addressing a Notification Backlog. There is a significant backlog of notifications that must be processed. According to information provided by the Controller, the backlog may be as high as 1.6 million. With a cap of \$35,000 on notifications, the Controller is able to mail notices to only 106,000 owners of unclaimed property.

As the Controller was given no additional funding in the current year to address the notification backlog, and none is proposed in the *1997-98 Governor's Budget*, it is up to the Controller to determine how much effort to put toward fulfilling the notification requirements, a flexibility provided by the Legislature when it removed the \$35,000 cap. Thus, the Controller can address the backlog through a redirection of resources, or an augmentation request to the Legislature during budget hearings.

Impact of Full Notification Requirement on General Fund Revenue. There is a direct relationship between the number of notifications made by the Controller and the number of claims filed by legal owners of property transmitted to the state. Reducing the backlog would accelerate, for a time, the filing of claims by legal owners of property transferred to the state. This would affect the General Fund in the form of increased pay outs to successful claimants, but only if additional resources were applied to claims-processing.

Analyst's Recommendation. While the amount of dollars potentially at stake is considerable, because almost all unclaimed property remains claimable without regard to time, the failure to address a growing backlog in the unclaimed property program raises an important public policy issue which we believe merits discussion before the Legislature. In the meantime, we see no justification for restoring a \$35,000 cap on notifications to apparent owners of unclaimed property, because doing so reverses current legislative direction and unduly restricts the ability of the Controller to fulfill her obligation to seek to locate rightful owners of such property in a timely manner. Consequently, we recommend that the restrictive language be deleted from the *1997-98 Budget Bill*.



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 of State appoints notaries public, registers auctioneers, and manages the state's archival function.

The budget proposes total expenditures of \$64.6 million for the Secretary of State in 1997-98. This is \$169,000, or 0.3 percent, less than current-year expenditures. Expenditures from the General Fund total \$33.6 million, a decrease of \$3.1 million, or 8.5 percent, compared to current-year expenditures. Expenditures were greater for 1996-97 primarily because of the costs of the 1996 General Election. Expenditures from the Secretary of State Business Fees Fund are projected to be \$23.4 million in 1997-98, an increase of \$2.1 million, or 9.7 percent, over current-year expenditures. This is due primarily to costs of implementing improvements in how the Secretary processes business filings and other corporate-related documents.

No Funds Proposed to Implement Proposition 208

We recommend that the Secretary of State and the Department of Finance submit a plan to the budget subcommittees, prior to budget hearings, that specifies how the Secretary will implement and enforce new campaign finance requirements imposed by Proposition 208. The plan should include an assessment of the resources needed in the budget year and how the resources will be provided, such as through redirection of existing resources in the Secretary's budget or budget augmentation.

In November 1996, the voters approved Proposition 208, the Political Reform Act of 1996. This measure makes many major changes to the state's campaign finance laws including setting limitations on campaign

contributions; mandating a variety of duties and responsibilities on candidates, contributors, and committees; and increasing sanctions for those who violate the provisions of campaign finance and disclosure laws.

Implementing Proposition 208. Since 1974, two state agencies have had responsibility for carrying out California's campaign finance and reporting laws—the Fair Political Practices Commission (FPPC) and the Secretary of State.

The FPPC is the agency responsible for determining if a candidate or other group has violated state campaign finance and reporting laws. The FPPC may hold a hearing to determine if a violation has occurred. If the FPPC finds that a violation has occurred, then they may impose a variety of sanctions, including monetary fines. Proposition 208 makes provision for an annual appropriation of \$500,000 to defray the costs of enforcing the new law. The *1997-98 Governor's Budget* for the FPPC includes the \$500,000, plus an additional \$1 million for the costs of implementing Proposition 208.

The Secretary of State has the statutory responsibility of receiving, filing, preserving, and providing for public inspection all campaign statements and campaign finance reports from candidates and other groups in support of candidates (including groups supporting initiative measures)—for statewide and local elections. In addition, the Secretary of State registers all lobbyists and lobbying firms. As the repository for all campaign statements and reports, the Secretary of State is responsible for the timely and accurate review of all disclosure documents. The Secretary of State is also required to ensure timely public access to all campaign disclosure documents.

Secretary of State Will Likely See Significant Workload Increases. In analyzing Proposition 208 for the *1996 General Election Ballot Pamphlet*, we determined that the Secretary of State would see a significant workload increase if the measure passed.

For example, many of the 10,000 existing political contribution committees must file new registration documents in order to comply with the provisions of the law. Furthermore, Proposition 208 creates a new contributor category ("small contributor committees") which will probably increase the number of new registration filings. In addition, the Secretary of State will have to ensure compliance with many new requirements for each of these committees, such as committee memberships and the length of time these committees have been established.

Additionally, the Secretary of State processes voluminous amounts of campaign disclosure documents, especially contribution and expenditure documents. In 1993-94, the last full year in which data were available, the

Secretary of State processed 900,000 pages of campaign disclosure documents. Under the provisions of Proposition 208, the number of these documents will probably increase significantly because of new disclosure requirements. Furthermore, the Secretary of State will have to ensure that each document meets the various new reporting requirements and the Secretary will need to ensure that its review is done in a timely manner. For example, under the new law, both the contribution and spending limits for candidates change if they fail to adhere to voluntary spending limits. Inaccurate or delayed Secretary of State compliance reviews could subject the state to litigation if inaccurate or late reviews effect the outcome of an election. Furthermore, voters could use the documents available from the Secretary of State for any civil suits against candidates in local courts. Inaccurate or delayed documentation could affect court decisions. Proposition 208 also establishes specific restrictions on when campaign funds can be solicited, received, and used thereby necessitating timely review of every document.

1997-98 Budget Request. The *1997-98 Governor's Budget* does not request any new resources for the Secretary of State to implement the provisions of Proposition 208, even though the Secretary of State's workload is likely to increase.

Analyst's Recommendation. In view of the above, we recommend that the Secretary of State and the Department of Finance submit a plan to the budget subcommittees prior to budget hearings that specifies how the Secretary will implement and enforce the measure. Specifically, the plan should include an assessment of the resources needed in the budget year and how the resources will be provided, such as through redirection of existing resources in the Secretary's budget or budget augmentation. To the extent that the plan calls for redirecting resources, it should indicate the programs from which the resources would be redirected, as well as the impact of proposed redirections on existing programs.

CALIFORNIA SCIENCE CENTER (1100)

The California Science Center, recently renamed after previously being known as the California Museum of Science and Industry, is an educational, civic, and recreational center located in Los Angeles. The center also has 26 acres of public parking, which are available for museum visitors as well as patrons of the adjacent coliseum and sports arena. These facilities are all located in Exposition Park, which is owned by the state and maintained through the center.

Associated with the center is the California African-American Museum, established by the Legislature to preserve, collect, and display artifacts of African-American contributions in a wide variety of disciplines.

The budget proposes total expenditures of \$13.8 million for the center in 1997-98. This is an increase of about \$5.7 million, or 70 percent, above the level of expenditures projected for the current year. The total includes \$11.4 million from the General Fund, \$2.2 million from the Exposition Park Improvement Fund, and \$232,000 in reimbursements.

About \$5.5 million of the additional funding would go to the California Science Center, while the California African-American Museum would receive a \$195,000 increase in its funding above the current-year level. The budget proposal also includes a proposed statutory change that would allow \$832,765 in revenue from the Exposition Park parking lots to be diverted to the center. Unless this statutory change is adopted, the funds would otherwise automatically be deposited in the General Fund. Thus, the proposed budget would provide the center with a total of \$6.3 million more in funding in 1997-98 than it would otherwise receive. The reasons for the proposed budget increase are outlined below.

Center Seeks Major Funding Increase To Open New Science Facility

We withhold recommendation on a \$6.3 million augmentation from the General Fund requested by the California Science Center to open its

new science and technology exhibit hall, pending receipt of a statutorily required study on the feasibility of transferring management and operation of the center to an auxiliary support organization. We also withhold recommendation on a proposed statutory change to shift center parking lot revenues from the General Fund to the center. In addition, we recommend that the Legislature consider the options of establishing admission fees at the center or partially supporting the center with Proposition 98 education funding in order to reduce the center's requested General Fund augmentation.

This fall the California Science Center is scheduled to complete the \$46 million state-funded reconstruction of the historic Howard F. Ahmanson Building, which center officials describe as a state-of-the-art science learning facility and an architectural landmark. In addition to the state funds used for reconstruction, other private and public fund-raising efforts have been led by the California Museum Foundation of Los Angeles, a nonprofit auxiliary that assists in the operation of the center. The foundation will provide many of the science and technology exhibits for the new facility.

Center Funding Proposal Detailed. Because the new facility is scheduled to open this fall, the center is requesting about \$6.3 million from the General Fund in the budget year, as discussed above, for center operations.

Specifically, the Governor's budget proposes the following additional funding for the center:

- \$2.2 million would be provided to contract for building and exhibit maintenance service and museum assistants. The funds would be sufficient to hire 63 additional personnel on a contract basis; no additional state employees would be hired.
 - \$344,000 would be provided for the one-time purchase of building maintenance equipment.
 - \$833,000 would be provided through a proposed statutory change that would allow the center to keep additional revenue it collects from its parking lots. The law requiring that this sum of money be deposited in the General Fund was suspended for 1996-97 to allow the center to adjust to a sudden major shortfall in parking lot revenues. The center indicates that the funds provided in 1997-98 would be used to maintain an 11-person security force that patrols the grounds of Exposition Park.
 - \$3 million would be provided to begin to retire \$33 million in lease payment bonds that will be sold to help fund the reconstruction of the Ahmanson Building.
-

In addition to the \$6.3 million in funding requests for the center's own facilities, the budget also proposes to provide the California African-American Museum with \$195,000 to hire a visual arts curator and an executive assistant who will coordinate traveling exhibitions and grant-writing efforts that could bolster the museum's finances.

Significant New Financial Commitment. Adoption of the Governor's budget proposal represents a significant new financial commitment to the support and operation of the California Science Center at a time when the center's ability to generate additional operating revenue from its own resources has waned. The relocation of the National Football League's Los Angeles Raiders to Oakland, and the subsequent loss of parking fees paid by football fans, has eroded parking lot revenues by nearly \$1 million. If the Governor's budget plan were adopted, General Fund support for the center will have more than doubled in just two years.

Because the new science center is about to open, and because the costs for the center's operations are proposed to increase so significantly, we believe this is the appropriate time for the Legislature to examine the way the museum is structured organizationally and financially.

Funding Alternatives Should Be Considered. Last year, the Legislature adopted Chapter 201, Statutes of 1996 (AB 3493, Committee on Budget), directing the center to study the feasibility of transferring the management and operation of the center complex to its auxiliary California Museum Foundation. The bill authorized the center to examine other alternatives it deemed appropriate. The center advises that a preliminary report on the issue will be provided to the Legislature as required by law by March 1, 1997. The law requires a final report to the Legislature by May 1, 1997.

One option we recommend be considered now is the establishment of visitor admission fees in accordance with the practice of many other privately and publicly supported museums.

Center administrators have indicated that they oppose the establishment of admission fees. They contend that they would undercut the center's goal of encouraging children, especially those from low-income families, to learn more about science and deter many of its estimated two million visitors per year.

While we agree that fees would have some impact on attendance, we believe the establishment of a reasonable fee would not have the major impact that the center administration fears. First, in keeping with the policy of other museums, we believe it would be appropriate to establish regular opportunities—perhaps one or more days each month—on which anyone could visit the center without paying a fee. We would note that

the Natural History Museum of Los Angeles County, adjacent to the center within Exposition Park, charges admission fees but also provides free visitation days that ensure no one is denied an opportunity to visit the facility because they cannot afford to pay a fee.

If the center charged fees equal to the fees charged by the Natural History Museum, (\$6 fee to adults; \$3.50 for older children, age 13 to 18, students, and seniors; and \$2 for children age 5 to 12) we estimate that the center could generate more than \$2.7 million during 1997-98 to offset the \$6.3 million General Fund augmentation requested in the budget. This estimate of potential revenue is conservative given that the center's new facility is well-planned and should prove highly attractive to visitors.

We believe the Legislature should also consider the option of funding part of the California Science Center budget with Proposition 98 education funding. We would note that the center's plans revolve around an educational mission and include the establishment of a science-oriented public school on the grounds of Exposition Park. In recent years, the state has provided Proposition 98 funding for several projects at other museums. Given this history, using Proposition 98 funding for specific educational purposes of the center (such as presentations, workshops, and exhibits specifically targeted to school children) is an option that the Legislature could consider.

As with the fee option, a switch to Proposition 98 funding, which would require a statutory change, could reduce the amount of the non-Proposition 98 General Fund augmentation requested by the California Science Center.

Analyst's Recommendation. Because of the potential significance of the ongoing study of restructuring the center's organization and finances, we believe the Legislature should defer final approval of the center's 1997-98 budget request until the study has been completed and the Legislature has considered the admission fee and Proposition 98 funding options. For these reasons, we withhold recommendation on the additional \$6.3 million requested by the California Science Center to open its new science and technology exhibit hall and the proposed statutory change to permanently shift more parking lot revenues to the center. We also recommend approval of the additional \$195,000 for the California African-American Museum.



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 these support services. It provides these services through two programs: statewide support and property management services.

The Governor's budget proposes total expenditures of \$544 million from various funds (including \$11.2 million from the General Fund) to support the activities of the DGS in 1997-98. This reflects a net decrease of \$15 million, or 2.7 percent, below estimated current-year expenditures. Approximately three-quarters of the department's funding is appropriated in other departments, and paid to the DGS for various services, primarily through the Service and Architecture Revolving Funds.

Statewide Support Services. Expenditures for statewide support services are \$337 million in the budget year, representing a decrease of \$14.8 million, or 4.2 percent, below estimated current-year expenditures. This decrease is the result of a number of factors, including a reduction in the costs of central supply stores because the DGS has contracted with a private business to provide the same services to state agencies at less cost (savings of \$9.6 million to the department). In addition, many expenditures made in the current year are not continued for the budget year because they were one-time-only expenditures.

Although there is an overall reduction in statewide support services, the budget also contains several individual increases in expenditures in this area. Major proposed increases include an augmentation for 911 system upgrades to better manage calls from cellular telephones (\$6.8 million), increased replacement of state fleet vehicles (\$5.9 million), continued replacement of microwave communications equipment (\$2.5 million), and continuation of technical services to various state agencies for radio and microwave-related services (\$1.6 million).

Property Management Services. Proposed budget-year expenditures for property management services are \$201 million—\$800,000 more than

current-year levels. Major changes include (1) a decrease of \$26 million for one-time expenditures in the local public buildings portion of the 1990 earthquake safety program, (2) an increase of \$27 million in the Office of Energy Assessments (which is a flow-through payment mechanism for the Natural Gas Procurement Program), (3) an increase of \$1.1 million to operate a new state office building in Oakland, (4) an increase of \$1.5 million for debt service payments on the Riverside State Office Building, and (5) a decrease of \$3 million for inspection services on prison construction due to completion of the last authorized prison in the fall 1997.

Departmental Performance: A Work in Progress

The department appears committed to improving the performance of its various operations.

Background. In 1993 the DGS was designated as one of four departments selected to participate in a performance budgeting pilot project initiated by the Governor with the objective of changing fundamentally the state's budget process and improving the performance of state programs. The department cited its involvement in the pilot project as demonstration of its commitment to improved performance, which we had found seriously lacking in our *Analysis of the 1993-94 Budget Bill*.

Department Appears Committed to Improvements. Although performance budgeting has not achieved many of the initial goals sought by the Governor (please see our analysis of the Department of Finance later in this chapter), it has created within the DGS a commitment to improved performance. This commitment is demonstrated not only by the considerable investment in time and resources dedicated to the project (estimated at approximately \$1.2 million in last year's *Analysis*) but by indications of improvement in several of the department's many separate operations. One example is the department's fleet operations. State employees are now able to reserve fleet sedans by telephone, thereby allowing a more productive use of staff time because they no longer have to travel to the state garage to determine whether a vehicle is available. The department has also demonstrated innovation and initiative by designing and ordering vans which provide a mobile office for departments with field operations.

In addition, the department has implemented in the current year a process that enables state agencies to purchase office commodities at a substantially reduced price through a contract with a private sector office supply firm. This has allowed the department to scale back significantly its own warehouse operations. Also noteworthy are efforts by the Office of Real Estate Design Services and the Division of State Architect to be

more customer-oriented, including the assigning of account managers to respond to the needs of major customer departments.

In our judgment, these and other improvements in departmental operations reflect a continuing commitment to reforming an institution long viewed by state departments subject to its authority as being burdensome, overpriced, and often resistant to change.

While recognizing progress has been made in improving the operations of the department, we discuss below areas where we believe the department's efforts can be improved.

STATEWIDE SUPPORT SERVICES

Should the State Continue to Maintain A Marginal Warehouse Operation?

We recommend the adoption of supplemental report language directing the Department of General Services to provide the Legislature, by December 1, 1997, a plan to phase out its surplus property warehouse operations.

The department manages two programs designed to reutilize surplus property. One program is to make surplus federal property available to local governments and non-profit institutions. The other is designed to reissue surplus state property to state departments, and if that is not possible, then sell it to the public. The budget includes \$2.3 million and 25.2 personnel-years in 1997-98 to support these two programs at warehouses located in Sacramento and Fullerton.

According to the department, much of the surplus state property which is reutilized never goes through either of the warehouses. Rather, it is distributed directly from the donor department to one or more other departments which have requested the property. Surplus state property sent to DGS warehouses is available for reissue to departments or purchase by the public, although certain items, such as file cabinets and conference tables, are held for 90 days before going on public sale. Surplus state property not reissued or sold within a year is sold to a recycler. Federal property which is not reissued within one year is returned to the federal government.

Warehouse Operations Are Marginal State Program. The department indicates that the surplus property programs had net revenues of about \$115,000 in 1994-95, but lost approximately \$408,000 in 1995-96. The department anticipates improving this situation in the current and budget years, but its estimates rely on increased sales.

Despite the marginal value of the surplus property warehouse operation, the department apparently has no plans to phase it out. This is occurring at the same time that the department is reducing its central stores warehouse function in favor of a contract with a private sector company which appears to meet the needs of state agencies for office supplies while also saving the department \$9.6 million in 1997-98. Moreover, the department indicates that it intends to reduce central stores operations further by making more items available directly to state agencies through contracts with private sector providers.

Analyst's Recommendation. We can find little or no value to the state in continuing its surplus property warehouse operation. Our review of material stored in the Sacramento warehouse found that much of it was of little or no monetary value. The program appears to operate at or near a net loss, and what service it does provide might well be accomplished at a significantly reduced cost through a contractual arrangement with the private sector. For these reasons, we recommend that the Legislature adopt the following supplemental report language:

The Department of General Services shall, by December 1, 1997, provide the Joint Legislative Budget Committee and the Legislature's fiscal committees with a plan to phase out its surplus property warehouse operations.

Will State Pay Telephone Contracts Be Extended or Rebid?

We withhold recommendation on \$451,000 and 2.8 personnel-years budgeted for management of the state pay telephone program pending receipt of a report from the Departments of General Services and Corrections, prior to budget hearings, as to their plans for the state pay telephone contracts and the status of the marketing analysis required pursuant to the Supplemental Report of the 1996 Budget Act.

Background. In 1986-87, the department contracted with private telephone companies to install and support pay telephones in state facilities, with a share of the receipts accruing to the General Fund. Since then, annual revenue derived from the state's share of pay telephone usage has grown from \$904,000 in 1986-87 to \$16 million in 1995-96. The department anticipates that revenue will increase to approximately \$18 million in 1997-98 based on current contracts with two private sector communications companies.

Approximately 72 percent of the annual revenue is derived from pay telephones at state prisons. About one year ago, the DGS and the California Department of Corrections (CDC) agreed to extend the two contracts until August 1997, apparently because they were unprepared to rebid the

contracts prior to the August 1996 expiration date. We believe that this decision may have cost the state several millions of dollars of additional revenue, because other states have been able to secure more favorable revenue sharing ratios for similar services.

Last year, the Legislature adopted supplemental report language directing that the DGS and the CDC jointly provide the Legislature their market analysis of the state's prospects for increasing General Fund revenue from prison system pay telephones, within 30 days after completion of their analysis. The Legislature also required a report within 30 days after rebidding the contracts, as to the level of General Fund revenue provided over the life of the contract, and changes in communications services provided to the state.

Consultant Recommends Delay in Rebidding State Pay Telephone Business. According to the DGS, a consultant it retained has advised the department to delay rebidding the state pay telephone business until August 1998. We understand that the recommendation is based on a concern that the effects of recent federal deregulation of communications service providers have not yet settled out, and therefore, now is not an opportune time to put the state pay telephone business up for bid. On the other hand, the department acknowledges that potential competitors are interested in bidding for the state business because of the amount of revenue generated by state pay telephones. The department indicates that it must make a decision soon as to whether to renew the contracts or rebid them.

Can the State Strike a Better Deal? In last year's *Analysis*, we expressed our concern that in delaying the rebidding of the state pay telephone business, the state was deferring an opportunity to improve its share of pay telephone receipts. We believed that an increased share of pay telephone revenues was possible, given that other states have negotiated higher percentages of revenue. In discussing with the department the possibility that the DGS may soon elect to renew the contracts set to expire in August 1997, the department expressed its belief that it would be able to increase the state's share by a significant margin. This suggests that the current revenue sharing ratios are in fact too low, and raises the question as to why the DGS did not renegotiate the state's share when it extended the contracts last year.

State Law Favors Competition. Although state law clearly favors competitive acquisition of services, the department's consultant has recommended that the contracts with the current vendors be renewed without a competitive bid process. In order to implement the consultant's recommendation, the department would have to justify renewal on a sole-source award basis. Generally, the law allows a sole-source award

to be made in the event of an emergency, for the public's health and safety, or when there is only one source available. It is not clear what justification the department would use to renew the state pay telephone contracts on a sole source basis. Moreover, in the absence of an open competition for the state's pay telephone business, it would be difficult, if not impossible, for the department to prove that it had obtained the best possible revenue sharing arrangement.

Analyst's Recommendation. We believe, and the department concurs, that the state's share of revenue derived from the state pay telephone program can be increased through negotiating and renewing current contracts. There is a question, however, as to whether doing so would be consistent with legislative intent regarding competitive bidding, and whether it would in fact produce the most favorable revenue sharing ratio for the state. There is also a question as to whether the DGS has allowed sufficient time to prepare for and conduct a competitive bid, and might therefore be inclined to favor renewal. Finally, the DGS and the CDC have not provided the Legislature with a required report on the prospects for increasing General Fund revenue from prison pay telephones given the competitive nature of the telecommunications market.

For these reasons, we withhold recommendation on \$451,000 and 2.8 personnel-years budgeted for management of the state pay telephone program, pending receipt of a report from the DGS and the CDC prior to budget hearings, as to their plans for the state pay telephone contracts and the status of the required marketing analysis.

Use of Sole-Source Contracts

We recommend that the department review its policy authorizing exceptions to the competitive acquisition of goods and services, and report prior to budget hearings as to how its policy is consistent with both legislative intent and direction from the Governor.

Background. Generally, as noted above, state procurement law requires the competitive acquisition of goods and services except in cases of emergency, public welfare, or safety, or where only a specific brand name or supplier can meet the state's requirements. In 1994, the Governor issued an executive order that was consistent with the Legislature's emphasis on competitive acquisition and limited the use of sole-source contracts to state emergencies or where required for public health and safety. The executive order requires that any sole-source contract be approved by the DGS and a Cabinet-level agency secretary or, for those organizations not reporting to an agency secretary, the highest-level employee of the organization.

Department's Actions Appear Inconsistent With Both Statutory and Administration Direction. In July 1996, the DGS issued a management memo to all state agencies for the purpose of implementing the Governor's 1994 executive order. The management memo notes that the executive order "... reinforces the state's policy whereby procurements or contracts for goods and services are to be awarded through the use of a competitive process." However, other parts of the management memo appear to be inconsistent with the Governor's executive order and the law in that it allows departments to enter into sole-source contracts when it is in the "best interests of the state," an exception that we have not found in statute or the executive order. Consequently, rather than reinforcing state policy governing competitive acquisition, it seems to weaken it.

In our opinion, the policy expressed in the July 1996 management memo provides a loophole which allows departments to circumvent the Legislature's and the Governor's policy direction because it provides an exception not found in statute or the executive order. In this regard, we note that last year the Department of Consumer Affairs (DCA), with the approval of the DGS, awarded a sole-source contract for the development and implementation of the DCA's Integrated Consumer Protection System. The sole-source award followed a competitive acquisition which the DCA canceled on the grounds that the single proposal which was submitted was too costly. Subsequently, the DCA awarded a sole-source contract to the firm which had submitted the lone proposal, specifying a different solution than that which had been proposed during the previous competition. When we asked the DCA as to the justification for what we believed to be a sole-source award, the DCA advised us that it was a "single-source," rather than a sole-source, award approved by the DGS. When we asked the DGS about this, we were advised that it was a sole-source award, although a "single-source" definition was being worked on. We are unaware of any provision of law that makes a distinction between a sole-source award and a "single-source" award.

Analyst's Recommendation. The DGS, as the administration's procurement agency, is responsible for overseeing state procurement activities, including the establishment and enforcement of policy governing the competitive acquisition of goods and services. As noted above, some of the department's actions in this regard do not appear to be consistent with state law and policy which favor competition for state contracts. Therefore, we recommend that the department review its policy authorizing exceptions to the competitive acquisition of goods and services, and report to the Legislature prior to budget hearings as to how its policy is consistent with both Legislative intent and direction from the Governor.

Approach to CALNET and State Telecommunications Networks Raises Questions

The Department of General Services (DGS) and the Department of Information Technology (DOIT) have proposed the divestiture of the state's telecommunications operations, in response to legislative direction to improve the cost-effectiveness of state telecommunications. Given the dependence of state operations on telecommunications, it is essential that the proposal be on a sound footing. Therefore, we recommend that the DGS and the DOIT report during budget hearings on the status of their efforts to implement the California Integrated Information Network Plan.

Background. The Department of General Services has broad oversight responsibility for state government telecommunications. In addition to a policy-setting and oversight role, the department also contracts for telecommunications services on behalf of state agencies, and manages the California Integrated Telecommunications Network (CALNET) to provide telecommunications services to state and local government.

In previous *Analyses* we have discussed the department's problems with CALNET, a statewide voice and data system estimated to cost about \$100 million when fully implemented. These problems include a net annual loss of approximately \$2 million from the sale of CALNET services to customer departments, and the reluctance of many state departments to acquire telecommunications services from the DGS, when they can acquire equivalent or better services at less cost from other sources.

Many departments are leery of the DGS when it comes to data communication services, because the department has failed twice in the last 20 years to sell statewide data services to departments. The Legislature, in approving the department's budget for the current year, adopted both budget act and supplemental report language to provide policy direction to the DGS regarding this situation. Specifically, in the DOIT's budget, the Legislature required that the DGS and the DOIT provide the Legislature, by October 31, 1996, the administration's plan for resolving the problems associated with CALNET, and a plan for consolidating the state's separate telecommunications networks in a manner that meets the service requirements of state departments at the same or less cost. The language further states the Legislature's intent that to the maximum extent practical, the administration should provide for the competitive acquisition of telecommunications services, including network management, in lieu of state ownership and management.

In addition, the Legislature adopted supplemental report language precluding any state agency that is not using a DGS service from being forced to acquire service from the DGS unless a specified process is fol-

lowed. That process requires that the Joint Legislative Budget Committee be notified in any event where a department's preferred alternative for acquiring telecommunications services is overruled by the administration.

Concerns with the CIIN Plan. In response to the budget act language, the administration released in January 1997 the *California Integrated Information Network* (CIIN) strategic plan. The plan identifies short-term measures intended to allow CALNET to recover the cost of its operation prior to the state divesting itself of this telecommunications infrastructure, and a long-term strategy to move to an integrated, privately owned and operated network. As discussed in our analysis of DOIT, we question whether the plan provides a sound basis upon which to divest an infrastructure which is of critical importance to many state programs. Although we do not take issue with the general concept of divestiture, we are concerned that the plan may be unrealistic in terms of its time frame, because it proposes to contract out for state telecommunications support by January 1, 1998. We believe that this is an unrealistic schedule for a number of reasons, including the DGS' own track record in meeting schedules for technology-related contracts. Moreover, DOIT—DGS' partner in this endeavor—is relatively new and has not established a track record which would warrant confidence in its ability to meet the January 1, 1998 date.

In addition to a concern with the plan's overall implementation schedule, we note that there is no schedule for the many critical project tasks which must be accomplished in order to implement the plan. The department advises that a detailed plan will be developed at a later date, at which point in time it will be possible to reassess the time frame required to implement the plan.

A further concern is that the plan's underlying premises are misleading; for example, an underlying premise is that owning and operating telecommunications networks are neither "core competencies" nor "core responsibilities" of the state. We believe that this premise is misleading if applied to the extensive telecommunications networks managed by the Department of Justice, the Health and Welfare Agency Data Center, and the Teale Data Center. However, the plan's premise is not qualified, and therefore suggests that state networks which have served many critical state programs for years are not competent operations.

State Departments Should Be Integral Part of Planning Process. The CIIN plan states that the DOIT consulted with staff and managers at major state data centers and state agencies. However, managers in departments we contacted indicated that no consultations had occurred, or those that did occur were minimal or focused on technical aspects of their

telecommunications, and not on their program needs. Departments whose operations depend on effective telecommunications systems are naturally reluctant to give up existing systems if they have not been a meaningful participant in the project to plan for a replacement and are going to be even less willing if they are not confident in the ability of the DGS and the DOIT to provide a fully responsive and cost-effective telecommunications service. Consequently, we believe a more effective approach to resolving the state's telecommunications situation would be to involve key state agencies in the project, similar to the 21st Century project initiated by the State Controller in 1995, which has involved several key departments in assessing the human resource management system needs of state departments in order to develop a unified approach to meeting these needs through new computer-based systems.

Policy Directive Conflicts With Recent Legislative Policy. On January 14, 1997, the DOIT released a management memo intended to begin implementation of the CIIN plan. The management memo requires state agencies to utilize contracts issued by the DGS to meet their departmental telecommunications needs for both voice and data services. As such, it appears to be in direct conflict with the supplemental report language discussed above, which prevents state departments from being forced to acquire telecommunications services from the DGS unless a specific process is followed.

Implementation of the CIIN Should Not Proceed Without an Approved Feasibility Study Report. The State Administrative Manual (SAM) requires that "... a feasibility study must be conducted prior to the encumbrance or expenditure of funds on any information technology project." (The Government Code includes telecommunications in the definition of information technology.) It is not clear whether the department intends to prepare a feasibility study in accordance with the SAM prior to proceeding with the consolidation and divestiture of state telecommunications operations, because the CIIN strategic plan is silent on this point. The plan indicates, however, that *some* components of a feasibility study will be addressed; for example, an analysis of costs and benefits. A properly prepared feasibility study should provide all stakeholders an objective presentation of the business case for the administration's consolidation and divestiture plans.

Analyst's Recommendation. Telecommunications services are critical components of state operations. Previous efforts by the DGS to provide statewide telecommunications services have not been successful, even when attempts have been made to force departments to use the department's services. For these reasons, we recommend that the DGS and the DOIT report during budget hearings as to the status of their efforts to implement the *California Integrated Information Network* strategic plan.

Department Only Partially Responsive To Other Legislative Direction

The department has not been fully responsive to supplemental report language relating to its annual strategic telecommunications plan.

In approving the current year's budget, the Legislature adopted supplemental report language directing the DGS to fulfill its telecommunications oversight responsibilities by maintaining an annual strategic telecommunications plan. In addition the Legislature required that the plan identify specific long-term goals, policies, procedures and annual objectives for improving statewide benefits obtainable from (1) CALNET, (2) the capital area fiber optic loop, (3) state telephone usage, (4) telecommuting, (5) videoconferencing, (6) telemedicine, (7) facsimile transmission, and (8) electronic commerce.

In its letter of transmittal for the CIIN plan, the department indicates that the plan satisfies the statutory requirements regarding the annual strategic telecommunications plan. Our review of the CIIN plan concludes that this is not the case, as the CIIN plan only specifically addresses two of the areas listed above—CALNET and state telephone usage. The DGS, in a recent letter to the Joint Legislative Budget Committee, indicates that it will include the other areas in a formal request for information to be issued in March 1997 to telecommunications service providers as part of the CIIN effort.

Plan to Reduce Government Paper Pending. The Legislature also adopted supplemental report language requiring the DGS, in conjunction with the DOIT, to provide the Legislature a plan for reducing, through the application of information technology and other methods, the state's costs associated with generating, handling and maintaining paper records. The report was required to be submitted to the Legislature by December 31, 1996. According to the DGS, it provided an original draft of the report to the DOIT on December 24, 1996. The DOIT and the DGS met on January 17, 1997, and a revised draft was given to the DOIT on January 22. In this instance, it appears as though the DGS has attempted to comply with the Legislature's reporting deadline.

Inadequate Justification for Expanded Fleet Expenditures

We withhold recommendation on \$5.9 million requested to replace vehicles in the state fleet maintained by the department, pending receipt of additional information from the department.

The budget for 1997-98 includes an increase of \$5.9 million to replace certain vehicles in the state fleet maintained by the DGS. This amount would be in addition to the baseline budget of \$6.9 million to maintain the 5,150-vehicle fleet. The proposed increase is based in part on a desire to replace sedan vehicles (roughly three-fourths of the fleet) when mileage exceeds 100,000 miles; however, the department acknowledges that it has well-maintained vehicles which continue to operate safely considerably beyond 100,000 miles. Moreover, the department was not able to provide compelling data to validate that 100,000 miles should be a maximum.

Rental Rates Would Increase Approximately 25 Percent Under Department's Proposal. According to budget documents, replacing the vehicles would result in an approximate 25 percent increase in rates the department charges other departments to rent vehicles. The department states that even with such a significant rate increase, its rates would still be well below the most favorable rental rates it has negotiated with private companies providing rental cars to state employees. It is not clear, however, whether the private sector could improve on the department's rates, because, to our knowledge, the state has not tested, through a bid or formal request, the private market's willingness to manage the state fleet.

Analyst's Recommendation. In the absence of information which would validate the department's position that state vehicles should be retired once they acquire mileage in excess of 100,000 miles, we are unable to recommend approval of the \$5.9 million requested to replace these vehicles. However, we recognize that the cost of new vehicles tends to increase, and that it is important to replace vehicles which have been damaged or become unsafe to operate, or which are simply not worth maintaining. However, the budget documents which have been provided do not indicate how much of the proposed \$5.9 million increase will be allocated to replacing high-mileage vehicles versus those that are damaged or unsafe to drive.

Pending receipt of this information, we withhold recommendation on \$5.9 million requested to replace vehicles in the state fleet.

Department Anticipates End of Cash Flow Problem in the 911 Program

Recently enacted legislation is anticipated to end a perennial cash flow problem in the State Emergency Telephone Number Account (911 Account).

In last year's *Analysis* we reported on the cash flow problems affecting the State Emergency Telephone Number Account (911 Account). The

account is used to collect and disburse to primarily local agencies funds necessary to support the 911 program. The funds to support this program are obtained from a surcharge on telephone bills collected by telephone companies and remitted to the state. For several years, including the current year, the DGS has had to borrow from the General Fund to provide sufficient cash flow to reimburse local agencies and the California Highway Patrol for their costs to support the 911 program. In the current year, \$10.1 million was borrowed. To correct this situation, we recommended that the law be changed to require telephone companies to remit the funds within 15 days following the month in which the surcharge was collected, rather than the several months of "float" which the law allowed.

The Legislature enacted Chapter 432, Statutes of 1996 (AB 3204, Knox), which now requires that telephone companies remit surcharge revenue to the state no more than three months after the surcharges were collected. As a result of this change, the department believes that it should not require a General Fund loan for 1997-98, despite increased expenditures of \$6.8 million in the budget year to upgrade emergency call systems to better manage calls made from cellular phones.

Proposed Performance Budget Contract Additions Should Not Be Included in the Budget Bill

We recommend that the Legislature not approve additional exemptions from statutory requirements sought by the department as part of its budget contract with the Legislature, because (1) it would be an inappropriate use of the budget bill, and (2) the department has not demonstrated significant performance improvement as the result of exemptions which have been provided to date.

In our analysis of the Department of Finance (DOF) later in this chapter, we discuss the state's performance budget pilot program, noting that exemptions from various statutes provided to pilot departments, including the DGS, do not seem to have produced significant improvements in departmental performance. We recommend that the Legislature not approve proposed additional exemptions from statutory requirements sought by the DGS as part of its budget contract with the Legislature, because it would be (1) an inappropriate use of the budget bill, and (2) the department has not demonstrated significant performance improvement as the result of exemptions which have been provided to date. (For a full discussion of this issue, please see our analysis of the DOF.)

PROPERTY MANAGEMENT SERVICES

Revise Leasing Notification Requirements

We recommend changes in the current law for leasing of state office space that would enhance legislative oversight by requiring notification to the Legislature (1) for of all high-cost leases and (2) earlier in the leasing process.

As the state's property manager, DGS is responsible for acquiring most of the general office space used by state agencies. This includes both state-owned space and space leased from the private sector. Statewide, agencies occupy about 21.6 million square feet of office space that is controlled by DGS. About 70 percent of this space—15 million square feet—is in leases from the private sector. Leasing of facilities for state agencies is the responsibility of the DGS's Office of Real Estate and Design Services (OREDS).

Current Leasing Procedures and Requirements. If a department is in need of office space, it submits a request to OREDS to obtain the space. OREDS works with the department to refine the space needs based on the number of staff to be housed and the department's program requirements. Concurrent with developing the space requirements, OREDS and the department determine the general location—for example within a particular city or close to an airport—that will meet the department's operational needs. After the space and location requirements have been established, OREDS begins selecting a site (usually with the aid of advertising) and the office will then either negotiate a lease or receive competitive bids and award to the lowest bidder. As the lease is negotiated, planners at OREDS work with the department to determine what, if any, alterations (also referred to as tenant improvements) are needed to meet the department's program requirements. When the lease is signed and the space to meet the department's needs is available, the department moves into the leased space.

The DGS has virtually unlimited authority to obtain leased space because the Director of General Services can enter into a lease, regardless of its length or cost, without legislative approval. Under current law, the director must notify the Chairperson of the Joint Legislative Budget Committee and the chairs of the fiscal committees in each house at least 30 days prior to entering into a lease agreement if (1) the lease is for a firm term of five years or longer *and* (2) the annual rental costs exceed \$10,000. This gives the Legislature a degree of oversight through review of these proposals but the Legislature does not have approval authority. Consequently even though the Legislature may disagree with the proposal, the director has the authority to enter into the agreement. In the past, the

director has seldom proceeded if the Legislature disagrees with a proposed lease. As discussed below, we recommend the Legislature change existing law to enhance legislative oversight in this area.

No Legislative Oversight of Most Leases. As discussed above, notification to the Legislature is required only for leases that include a five year or longer firm term and annual costs exceeding \$10,000. Under current practice by the administration, these limits result in the Legislature not receiving notice of most lease agreements. For example, over the two-year period 1994-95 and 1995-96, OREDS entered into or renewed 373 leases. Figure 12 summarizes the number of leases and the varying ranges of annual lease cost for them. As shown in the figure, only 47 of these leases (13 percent) had a firm term longer than five years (all over \$10,000 in annual rents) and thus required notification of the Legislature. The Legislature was provided a review opportunity for leases with a total annual cost of \$28.5 million while no review was afforded for leases costing \$46.6 million.

Figure 12

**State Leasing Activity
1994-95 and 1995-96**

Annual Rent	Firm Term of Lease	
	Leases Less Than Five Years	Leases Five Years Or Longer
Up to \$50,000	131	—
\$50,000 to \$100,000	81	5
\$100,000 to \$250,000	68	13
\$250,000 to \$500,000	32	13
\$500,000 to \$1 million	9	7
Over \$1 million	5	9
Total Leases	326	47
Total Annual Lease Cost	\$44.6 Million	\$28.5 Million

Based on our experience over many years, we believe the Legislature would have a more meaningful review of proposed leases if this review focused solely on the lease amount rather than a combination of lease amount *and* lease term. While a long lease term generally is deserving of greater legislative review, many leases have been signed that are under five years. As a result, it is probably more productive for the Legislature to concentrate on the higher-cost leases, regardless of lease term.

We therefore recommend that the Legislature modify existing law to require the administration to notify the Legislature for all leases with average annual rental costs of \$250,000 or more. This will give the Legislature the opportunity to assess the merits of lease proposals in relation to an agency's program, space needs, and operating budget. If this level of review had been in effect during 1994-95 and 1996-97, the Legislature would have received notifications for 75 of the leases in Figure 12.

Notifications Should Be Made Early. As indicated earlier, prior to entering into a lease agreement, the director is required in specific instances to give the Legislature a 30-day review of the proposal. This notification should occur at a point in the process that makes the Legislature's review meaningful. Thus, legislative review should occur *after* OREDS has determined that the department's space needs should be met through leasing and *before* OREDS has solicited proposals from potential lessors. At this earlier point in the process, OREDS should be able to provide the Legislature with an estimate of the annual cost to the department based on the amount of space needed and market conditions in the proposed leasing area.

Notification before OREDS solicits for lease proposals gives the Legislature the opportunity to review the proposal and advise the administration of any concerns before OREDS, the department, and the private sector spend considerable time and money finalizing a leasing proposal. For example, this latter situation occurred when OREDS recently sought new leased space for the Stephen P. Teale Data Center. In this case, OREDS pursued a build-to-suit data center with a 20-year lease and did not notify the Legislature until negotiations were completed and an agreement was ready to be signed between the state and a developer. The Chairperson of the Joint Legislative Budget Committee notified the director of specific concerns with the proposal at which point the DGS postponed signing an agreement until additional studies are completed.

In order to (1) avoid situations like that described above and (2) provide the Legislature an opportunity to review leases in a way that is cost-effective for the state and the private sector, we recommend amending current law to require notification to the Legislature prior to solicitation of proposals for lease space.

Recommendation. Our recommendations, as described above, would require changes to Section 13332.10 of the Government Code as shown below:

The Director of General Services may not enter into a lease agreement between the state and another entity, public or private, in which the state is lessee if the agreement is to be for the lease of a building or building space, or both, which will be for the occupancy of any agency or agencies

of the state with a ~~firm lease period of five years or longer and an annual average rental, over the term of the lease, in excess of ten thousand dollars (\$10,000)~~ *two hundred fifty thousand dollars (\$250,000)*, unless not less than 30 days prior to *soliciting proposals for entering into* the lease the Director of General Services notifies the chairperson of the committee in each house which considers appropriations and the Chairperson of the Joint Legislative Budget Committee, or his or her designee, in writing of the director's intention to ~~enter into the agreement~~ *solicit proposals for such a lease*, or not sooner than such lesser time as the Chairperson of the Joint Legislative Budget Committee, or his or her designee, may in each instance determine. No funds appropriated in any Budget Act may be encumbered or expended for any lease entered into on or after July 1, 1979, for office space in the County of Sacramento unless all solicitations for leases for office space in the County of Sacramento under the above-described conditions contain the statement, "The state is anticipating capital construction in the City of Sacramento and intends to eventually reduce the use of space on a leased basis."

Surplus Property Assessments

We withhold recommendation on \$100,000 under Item 1760-015-0002(g)(1) for a property development study of property at the California Institution for Men prison site in Chino, pending completion of the master plan for that site.

The budget includes \$1.7 million to pay consultants for various studies related to potential selling or leasing 16 state properties. The amounts requested for each property are listed under Item 1760-015-0002. Under Chapter 193, Statutes of 1996 (SB 1770, Johnston), the Director of General Services was given authority to sell or lease most of these properties, which were previously identified as part of the state's Surplus Property Inventory. Disposition of a few of the sites, such as the state San Bernardino State Building and the San Diego State Garage, was authorized in other legislation.

The purpose of the consultant studies is to obtain information about the characteristics of the properties so the state can maximize its return through selling or leasing. The studies can include environmental assessments, engineering investigation of soils, toxic materials, and site infrastructure, and planning and zoning reviews. For example, DGS used similar funding provided in recent years to obtain changes in the land use designation for a portion of the Agnews Developmental Center in San Jose. This change, from agriculture/open space to allow the development of office space, significantly increased the value of the property and hence the state's return from the sale of the property to a private firm.

One of the 16 proposals for 1997-98 involves the California Institution for Men in Chino. The DGS, in conjunction with the Department of Corrections (CDC), is currently preparing a master plan for this 2,200-acre prison site, for which \$250,000 was funded in the *1995-96 Budget Act*. It is our understanding that the main purpose of the master plan is to determine to what extent the property is needed for CDC's current and future needs. The 1997-98 budget proposes an additional \$100,000 to prepare a property development strategy for the site. We withhold recommendation on this request pending completion and review of the master plan, which should be available prior to budget hearings.



STATE PERSONNEL BOARD (1880)

The State Personnel Board (SPB) has the authority under the State Constitution and various statutes to adopt civil service rules and regulations. An executive officer appointed by the board is responsible for administering the merit aspects of the state civil service system (the Department of Personnel Administration administers the nonmerit aspects of the state's personnel systems). These duties include, but are not limited to, adopting classifications within the State Civil Service System, conducting hearings and appeals on matters of discipline for civil service employees, and developing and administering the merit-based civil service hiring and promotional process.

The board and its staff are also responsible for establishing and administering, on a reimbursement basis, merit systems for certain city, county, and civil defense employees, to ensure compliance with federal requirements. The SPB is also responsible for coordinating affirmative action and equal employment opportunity efforts within state and local government agencies, in accordance with state policy and federal law.

The budget proposes \$13.9 million for support for the SPB in 1997-98, which is \$1.2 million, or 8 percent, below current-year estimated expenditures. The proposed expenditures consist of \$5.6 million from the General Fund and \$8.3 million in reimbursement from other departments.

Augmentation Unnecessary to Review Civil Service Classifications

We recommend that the Legislature delete \$219,000 from the General Fund for 2.3 limited-term personnel-years to review state civil service classifications because this work is fundamental to the State Personnel Board and should be undertaken on a priority basis within the current budget. (Reduce Item 1880-001-0001 by \$219,000.)

The SPB has requested three one-year limited-term positions (2.3 personnel-years [PYs]) to conduct a review of the current civil service

classification system (which includes approximately 4,600 job classifications) with the goal of reducing the number of classifications. The proposed review includes collection and analysis of data on job duties and salaries in the existing classifications, identification of legal issues related to changing the existing classification system, and reviewing any proposed new classification model's implications for the civil service examination system.

This is the same request presented to the Legislature for the 1996-97 budget. The Legislature denied the request last year and as discussed below, we recommend that the Legislature deny the request this year.

The number of civil service classifications is too large and needs to be reduced to a more manageable number. The need to augment the SPB budget and staff to undertake this task, however, should not be necessary. The proposed review is central to two of the SPB's most fundamental purposes—adopting the classifications within the state civil service system and developing and administering the state civil service merit examination system. The SPB should undertake the proposed review by setting this task as a priority within the current budget.

In addition, the SPB indicates that the proposed review is in anticipation of the completion of current negotiations on the Memoranda of Understanding (MOUs) between the Department of Personnel Administration and the 21 collective bargaining units representing state employees. The SPB indicates that there is an expectation that the final MOUs will include provisions for classification consolidation/broadbanding. Whether this will be the case or not is certainly unknown at this time. As discussed in our analysis of employee compensation issues in this section of the *Analysis*, the MOUs for 20 of the bargaining units expired June 30, 1995 and the administration has not indicated when they expect to conclude current negotiations. The other MOU (for the California Highway Patrol) expires June 30, 1997. Given this situation, the SPB should advise the Legislature whether the proposed review would be meaningful and whether the SPB can implement changes without final MOUs that allow such changes to the civil service classification system.

Based on the above issues, we recommend that the Legislature delete the \$219,000 and 2.3 PYs requested for review of the state civil service classification system.

The SPB Should Not Relocate Offices

We recommend that the Legislature adopt budget bill language to not allow the State Personnel Board's proposed move to the Food and Agriculture Building because the office space in this building should be occupied by state employees currently located in leased space.

The Department of General Services (DGS) is requesting \$1 million in the budget year (Item 1760-301-0666) to alter vacated laboratory space in the state's Food and Agriculture Building in Sacramento to provide office space for state employees. According to the DGS and the SPB, the plan calls for moving the SPB from the state-owned building at 801 Capitol Mall, Sacramento to the Food and Agriculture Building. Based on this plan, the SPB would need to spend \$500,000 to purchase and install modular furniture in order to occupy the space. The Governor's budget, however, does not propose any funding in the SPB budget for this purpose. We believe that the lack of funding for the SPB is appropriate because the SPB should not move from its current location in a state-owned building. Instead, if the Legislature approves the DGS \$1 million alternation proposed, the altered space should be occupied by state employees who are currently in leased space. This would reduce the state's cost for leasing office space. (A detailed discussion of this project is in our analysis of the DGS in the Capital Outlay section of this *Analysis*.) Consequently, we recommend that the Legislature adopt the following language to assure the SPB does not move to the Food and Agricultural Building:

The State Personnel Board shall remain in the existing building located at 801 Capitol Mall, Sacramento. No funds appropriated in this item shall be used to relocate the State Personnel Board staff or functions from this location.

TRADE AND COMMERCE AGENCY (2920)

The Trade and Commerce Agency—created in 1992—is the state’s primary economic development entity for promoting the establishment, retention and expansion of business, employment, and international trade in California. It promotes tourism and foreign investment as well. The Agency also has been designated as the entity leading the state’s efforts in defense conversion.

The budget proposes expenditures of \$77.1 million from various funds, including \$46.4 million from the General Fund, for the Trade and Commerce Agency in 1997-98. The total budget is \$12.6 million, or 14 percent, less than estimated current-year expenditures. This is mainly due to a reduction in various special funds for one-time costs for local economic development projects. The General Fund expenditures are proposed to decrease by \$1.2 million, or 2.5 percent, in the budget year. The General Fund reduction consists of about \$3 million in reductions for grant programs, partially offset by a \$1.8 million increase in economic development and the establishment of three additional foreign trade offices.

New Foreign Offices

We recommend that the Legislature delete \$939,000 requested for three new foreign offices because establishing foreign offices should be considered as a policy issue through legislation other than the budget bill.

The budget includes \$939,000 from the General Fund to establish three new foreign offices—Shanghai, China; Seoul, South Korea; and Sao Paulo, Brazil. The agency proposal calls for two positions at each location, funded through augmentations to the current foreign offices in Hong Kong, Japan and Mexico respectively. The agency also has included \$70,000 in the request for the Hong Kong office to continue a contract established in the current year for a consultant to maintain a presence in Jakarta, Indonesia. The requested \$939,000 would bring the total budget for these offices to \$5.4 million, a 20 percent increase compared to

current-year estimated expenditures. Compared to 1994-95 expenditures, the proposed budget represents a 100 percent increase.

Background. The state currently operates foreign offices in Tokyo, London, Mexico City, Frankfurt, Hong Kong, Taipei, and Johannesburg. There is also a representative office in Jerusalem, operating as the California-Israel Exchange, and a consultant contract for representation in Jakarta. According to the agency, the purpose of the foreign offices is to build additional business for the state that would not otherwise have been brought to California. In assessing the need for new offices, the agency considers:

- Economic factors, such as economic strength of a country, macro-economic stability, market potential, infrastructure development, level of international trade and investment and existing economic relationship with California.
- Strategic factors, such as the role of the region in which the country is located, need for specific on-site assistance to California companies and international programs, need for assistance in overcoming language, business and cultural barriers and ability of the office to serve as a hub for the region.
- Input from businesses is considered decisive in considering the demand for a new location.

The agency indicates that the proposal in the budget represents its determination of the three highest priority locations for new foreign offices. The agency's next priorities in order of priority are Singapore, Chile, and Poland.

In addition to the foreign offices, the agency operates international trade and investment programs through the Office of Foreign Investments, Office of Export Development, Export Finance Office, Environmental Export Program, Office of Trade Policy and Research, and the Office of California-Mexico Affairs. California companies also have available the U.S. Department of Commerce, U.S. Department of Agriculture, and the U.S. Agency for International Development located around the world in embassies and consulates of the United States. In addition, the American Chamber of Commerce network helps support United States companies and the World Trade Center in New York operates as a franchise-driven membership association. Thus, California companies have wide-ranging and extensive resources available for assistance in the foreign market.

Legislative Policy Decision. We believe that the establishment of foreign offices is a legislative policy decision that should be considered

in policy legislation rather than through the budget. Specifically, the appropriate policy and fiscal committee in each house should consider policy issues such as (1) the extent that state government should be involved in foreign investments and trade; (2) criteria for determining when and where to open foreign offices; (3) methods for quantifying the benefits to the state that are a direct, and indirect, result from each existing and proposed location; and (4) the funding for these efforts (for example, since business is a major benefactor from these offices, should there be a sharing in the cost?). These decisions also need to be made in the context of other state and federal government activities in foreign investment and trade. These and other issues should be considered through legislation other than the budget bill. After specific policies are adopted by the Legislature, the cost of operating the foreign offices established under these policies would appropriately be considered in the annual budget bill. Consequently, we recommend that the Legislature delete the \$939,000 requested for new foreign offices.

Tourism Marketing Act

We recommend that the Legislature direct the agency not to contract with the state Franchise Tax Board to collect and enforce business self-assessment fees for the Tourism Marketing Program.

Background. The California Marketing Act was established by Chapter 871, Statutes of 1995 (SB 871, Johnston). Under this Act, California businesses that benefit from travel and tourism can, by referendum, decide if they want to assess themselves to help finance a marketing effort for tourism and travel in California. Under the Act, these self-assessments would be combined with state funds (the Act indicates legislative intent to provide a minimum of \$7.3 million annually) for this marketing effort. The Act is to be implemented in phases, as follows.

In the initial phase, the 25-member committee (consisting of industry representatives of four major industry categories) established by Chapter 871 must develop the initial referendum, determine the segments of the industry to be included in the initial referendum, target the assessment level, and establish an assessment methodology. This work has been completed. The commission has targeted the initial assessment level at \$7.5 million based on assessing each business \$450 per \$1 million in gross revenue from tourism and travel. This assessment is based on business location. Therefore, if a business has more than one location in California, an assessment will charge for each location. A maximum assessment of \$250,000 per business location has been established by the commission. Businesses that do not respond to an informational mailing (discussed below) will not be eligible to vote on the referendum to establish this

program. If the referendum is approved, however, these businesses will be assessed at the highest level in their segment of the industry.

The next step is to solicit identified California businesses to determine whether a business wants to participate in the referendum and to obtain from each business an estimate of their gross revenue from tourism and travel. After receiving this information, a referendum will be sent to each business that responded to the solicitation for information. Voting on the referendum will be weighted based on the annual assessment for that business. For example, a business with a \$900 annual assessment will have three times the weighted vote of a business with a \$300 assessment. The referendum will be approved based on a simple majority of weighted votes. The solicitation for information and the referendum are scheduled to be completed this summer.

If the referendum is approved, the California Travel and Tourism Commission will be established. The commission will be comprised of 37 members—including the Secretary of the Trade and Commerce Agency, 24 members elected by industry vote (part of the initial referendum) and 12 members appointed by the Governor. Under terms of the Act, the commission is a separate, independent California nonprofit mutual benefit corporation. The commission is to be administered by an executive officer who is recommended by the commissioners and approved by the Governor, serving at the pleasure of both. The executive director is also to serve simultaneously as the director of the state Office of Tourism with the title of Deputy Secretary of Tourism in the agency and is an exempt employee of the state. The executive officer salary and benefits are to be determined by the commission, and approved by the secretary, based on industry standards for a director of a marketing budget of similar size. The act specifies that the assessed funds shall be under the control of the commission.

Inappropriate for the Franchise Tax Board to Collect and Enforce Self-Assessments. Under the Act, the secretary of the agency is responsible for the solicitation of information and the initial referendum. State funds available to the Office of Tourism may be used only for that purpose. The secretary has decided to use the state Franchise Tax Board (FTB) to mail out and receive the information and the referendum. To accomplish these tasks, the Department of Finance advised the Joint Legislative Budget Committee (under provisions of Control Section 28.50 of the *1996-97 Budget Act*) of the intent to approve a \$1.5 million reimbursement from the agency to FTB. According to the Governor's budget, these initial tasks would involve 26 new positions at the FTB, (at a cost of \$1.5 million). (FTB also has requested authority to spend nearly \$2 million in reimbursements from this program in 1997-98 for the purpose of collecting and enforcing the self-assessments from the various businesses.) The

committee responded to the department's letter by advising FTB (1) to proceed with the referendum-related tasks only, (2) that the tasks should be accomplished at far less cost, and (3) that it was unclear why FTB should be involved in an ongoing capacity.

With regard to the proposed budget year costs, there is very little information on how FTB will be paid for these activities. Based on conversations with agency staff, the current thinking is that the agency would contract with the commission to receive assessment funds for the activities to be performed by FTB. The agency would then enter into an interagency agreement with FTB. The board would administer collections and enforcement and deposit funds received from tourism businesses into a private account established by the commission. As mentioned above, other than the initial referendum, the state is not responsible for any costs related to the self-assessment program.

We have the following concerns with the agency using FTB for collecting and enforcing the self-assessments:

- First and foremost, FTB exists to ensure that state-required tax payments (and certain other legally required payments) are made. In our view it is unwise to use the board's name and authority to collect a voluntary, privately assessed fee.
- There is no assurance that the referendum will pass. Therefore to begin hiring staff in FTB in order to administer collections and enforcement is premature and could result in a General Fund cost to pay for staff and operating costs incurred before the referendum results were known.
- The costs of using FTB seem excessive. Based on the commission's goal of \$7.3 million for the initial assessment, FTB would absorb 27 percent of the assessments in collections costs.

Based on all the factors discussed above, we recommend that the Legislature direct the agency not to use FTB for administering the collection and enforcement of this self-assessment program. (In our analysis of the FTB budget in this section of the *Analysis*, we have recommended deletion of the reimbursement expenditure authority.) We therefore recommend that the Legislature adopt the following budget bill language:

Except as otherwise specifically provided in law, the Trade and Commerce Agency shall not use, or otherwise allow the use of, the state Franchise Tax Board for collection or enforcement of the self-assessment program under the California Tourism Marketing Act.

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, 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.

The budget proposes total expenditures of \$29.4 million for support of the department in 1997-98. The principal funding sources are:

- \$6 million from the General Fund.
- \$16.4 million from reimbursements from other state departments.
- \$6.2 million from the Deferred Compensation Plan Fund.

The proposed expenditures for DPA support are \$4.8 million, or 19.5 percent, above estimated current-year expenditures. Most of this increase is in anticipated reimbursements from departments who will contract with DPA for assistance in (1) "total quality management" under the Statewide Continuous Improvement Program and (2) a proposed executive leadership development program. The budget also proposes a \$0.7 million increase in General Fund support, most of which would be used to review the state's Human Resources Management System (basically the personnel and payroll systems).

Proposed Review of Personnel and Payroll Systems

We recommend that the Legislature delete the request for \$585,000 from the General Fund for a business process review of the state's personnel and payroll systems because the need for or extent of such a review is unclear at this time and a review of this nature would more appropriately be conducted through the State Controller's Office, rather than the Department of Personnel Administration. (Delete \$585,000 from Item 8380-001-0001.)

The DPA requests \$585,000 from the General Fund to conduct a "Business Process Review" of the state's personnel and payroll systems. The DPA request includes six personnel-years (PYs) on a permanent basis, plus approximately \$200,000 in consulting services.

The DPA proposal involves the following five elements:

- Identify essential information needed by the main personnel agencies to perform the state's personnel and payroll functions.
- Document current personnel administration processes.
- Anticipate which personnel administration processes might change as a result of any changes to the civil service system.
- Identify the best elements of the systems.
- Obtain substantial information from state departments on what is needed to improve the state's current human resources system.

As discussed below, this proposal is premature and if a proposal of this nature is to proceed it should be undertaken by the State Controller's Office (SCO) rather than DPA.

Existing Task Force. In 1996, the SCO, which operates the state's personnel and payroll systems, initiated the "21st Century Task Force"—consisting of representatives from SCO and eight other state agencies (including DPA). The task force, with the help of a private consulting firm, is currently examining the state's personnel and payroll systems, as well as the state's personnel policies and practices. The task force was scheduled to release a report on this examination in January 1997. When this *Analysis* was prepared, the report was not available. Consequently, we recommend that the Legislature not fund any study as proposed by DPA until the task force releases its report and the Legislature has the opportunity to review the findings of the task force.

State Controller Should Conduct Review. If based on an evaluation of the Task Force report the Legislature decides to fund a further review, the review should be conducted by SCO. The SCO is responsible for and

operates the state's personnel and payroll systems. Consequently, SCO has working knowledge of the current systems, and has the staff with expertise that is needed for review of these systems. Clearly, any study of this type would require SCO staff to confer and coordinate with all departments, especially DPA. The basic responsibility for the final system, however, rests with SCO, and we find no analytical basis to shift this responsibility to DPA. Thus, we recommend that the Legislature not approve the \$585,000 request for DPA to conduct this review. Once the task force report is available for legislative review, an effort of this type may be appropriate for consideration under the SCO budget.

Executive Leadership Training Program

We recommend that the Legislature not approve \$775,000 in reimbursement authority to initiate an executive leadership training program until the Department of Personnel Administration provides specific information on (1) problems with the current practice of using private and public seminars for this training and (2) the benefits of the proposed training (at a cost of \$5,000 per executive) compared to the existing practice.

The DPA requests \$775,000 for one position (\$100,000) and consultant services (\$675,000) to establish the California Leadership Institute (CLI). The "institute," modeled after the Federal Executive Institute, would be a DPA program to provide training for about 1,000 "top-level executives" in state government. For the most part, these executives are Governor's appointees and other high level managers in the administration. The DPA expects CLI to initially offer two 180-hour programs with approximately 45 participants per program. The department estimates that after the initial year of operation there will be 145 participants in the program on an annual basis at a cost of \$5,000 per participant. Based on this estimate, it would take seven years and \$5 million to provide training for 1,000 executives.

The DPA indicates that the curriculum for the CLI executive training program is being developed so that executives will obtain leadership training in areas such as strategic planning concepts and managing for results, and that participants will also be required to apply the "new" concepts through "hands-on" mentoring of other staff for departments that request their help. Currently, state executives typically attend private and public seminars to meet their training needs.

While providing training for all state employees is important, DPA has not substantiated the need for the state to initiate the proposed program. State executives currently meet training needs through existing private and public seminars. The DPA has not provided evidence indicating that

the current practice is either inadequate or ineffective. Moreover, DPA has not identified, other than in broad terms, what training deficiencies exist at the current executive levels or what specific programs will be offered by CLI to address these deficiencies. Finally, the department has not provided any evaluation of the cost-effectiveness of this proposal compared to current practice.

As mentioned above, the need to provide training to all state employees is important. Prior to embarking on the proposed executive training program, however, we believe it is incumbent on the administration to demonstrate the cost-effectiveness of the proposal. Consequently, given the concerns discussed above, we recommend that the Legislature not approve the \$775,000 requested to initiate this program until DPA provides specific information on the problems with current training practice and the benefits of the proposed program compared to existing practice.

Administration of Workers' Compensation Claims

We recommend that the Department of Personnel Administration report to the Legislature on what steps it will take to reduce state costs through the upcoming negotiations with the State Compensation Insurance Fund for a new Master Agreement to administer workers' compensation claims for state departments.

Currently, virtually all state agencies and departments self-insure for workers' compensation claims. Administration of workers' compensation claims is provided by the State Compensation Insurance Fund (SCIF) under a Master Agreement contract that is negotiated with and signed by DPA. The current agreement expires on June 30, 1998. Thus, DPA and SCIF will conduct negotiations during the budget year to reach a new Master Agreement covering all uninsured state departments.

Under the current agreement, SCIF charges all state departments a \$103 monthly fee per disability claim to perform functions such as processing claims, adjusting and categorizing claims in accordance with existing workers' compensation laws, and keeping accurate records on each workers' compensation case. If a case is litigated, SCIF charges another \$68 monthly fee per disability claim for legal services.

State Costs Increased Under the Current Agreement. In 1995-96, the state paid SCIF \$41.5 million for administration of workers' compensation claims. (These costs are expected to increase to \$44 million in both 1996-97 and 1997-98.) In comparison, in 1993-94, the year before the current master agreement became effective, these administrative costs were \$31.2 million. Thus, in the first two years under the current agreement, annual state costs increased by over 33 percent. On the other hand, during the same two years the total number of disability claims filed by the

state has increased by only 2.1 percent (17,745 claims in 1993-94 to 18,123 claims in 1995-96). In one case, the California Highway Patrol, SCIF administrative costs have increased from \$3.8 million in 1993-94 to \$6.4 million in 1995-96, a 68 percent increase, while during the same period claims decreased by 8.5 percent. (This is discussed in more detail in our analysis of the California Highway Patrol's budget in the Transportation Section of this *Analysis*.)

In view of the higher costs experienced under the current Master Agreement and the impending negotiations for a new agreement, we recommend that DPA report to the Legislature during budget hearings on what steps will be taken in its negotiations with SCIF to lower the state's costs under a new Master Agreement.

Collective Bargaining Agreements Still Under Negotiation

We recommend that the Department of Personnel Administration report to the budget committees during budget hearings on the administration's collective bargaining proposals and the status of negotiations.

The DPA began negotiations in 1995 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 are to replace MOUs that expired June 30, 1995. In October 1995, DPA reached agreement with bargaining unit 5 (California Highway Patrol officers). This MOU expires, however, on June 30, 1997. Thus, if DPA does not complete negotiations with any of the 21 bargaining units by the end of the current year, the state will begin another budget year with expired MOUs for all 21 bargaining units. Under current law, the provisions of expired MOUs generally remain in effect pending adoption of replacement MOUs.

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 state 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 legislative consideration as part of the budget process. At the time this *Analysis* was written, DPA indicated that the administration's current collective bargaining proposals are:

- To modify the state's layoff process by making it shorter and less costly.
 - To institute a third-party review and binding decision for minor discipline cases.
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- To make salary increases a function of performance-based salary reviews.
- To eliminate appeals of rejection on probation unless rejections are a result of political patronage or discrimination.
- To cease to require that departments bargain the effects of minor policy changes that affect the working conditions of employment.
- To eliminate counting time not worked (such as vacation or jury duty) when computing overtime.
- To merge employee contribution rates for health, dental, and vision benefit plans into one combined contribution.
- To establish a defined contribution pension plan option for state employees.
- To develop a less lengthy rulemaking procedure for personnel practices.
- To eliminate three holidays and increase vacation and/or annual leave accrual and caps by 24 hours each year.

In recognition of the statutory intent and the importance of these negotiations for the 1997-98 budget, we recommend that DPA report to the budget committees during budget hearings on the administration's collective bargaining proposals and the status of negotiations. Furthermore, in our *Overview of Employee Compensation Issues* in this section of the *Analysis*, we have recommended that the Legislature adopt the following policies for reviewing and approving new MOUs:

- 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 the 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 ensure 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.



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.

The Governor's Budget proposes expenditures of \$29 million (\$22 million from the General Fund) to support the activities of the DOF in 1997-98. This is \$269,000, or approximately 1 percent, more than estimated current-year expenditures.

Oversight of the Performance-Budgeting Pilot Project

We recommend that the Department of Finance advise the Legislature during budget hearings as to the status of the performance-budgeting pilot project, the administration's future plans for performance budgeting, and the extent to which administrative flexibilities provided pilot departments should be provided to all state agencies.

Background. In 1993, the Governor proposed a performance-budgeting pilot program involving four departments. The purpose of the pilot was to test the concept that performance budgeting could result in substantial cost savings, improved program performance, enhanced citizen satisfaction, and greater accountability. The program was subsequently enacted in Chapter 641, Statutes of 1993 (SB 500, Hill), as the Performance and Results Act of 1993. In accordance with Chapter 641, DOF is responsible for oversight of the program, and was required to evaluate the pilot and report its evaluation to the Legislature by January 1, 1996.

Four Departments Remain Active Participants in Pilot Program. There are currently four departments participating in the pilot program: (1) California Conservation Corps, (2) Department of Consumer Affairs,

(3) Department of General Services, and (4) Department of Parks and Recreation. Pursuant to Chapter 641, each department has entered into a budget "contract" with the Legislature. The contracts are adopted as part of the Legislature's review of the Governor's budget, and have been in the form of budget act language, budget trailer bill language, and memoranda of understanding included in the supplemental report of the budget act. Chapter 641 requires that annual budget contracts commit pilot departments to deliver identified outcomes for a specified level of funding. As we noted in last year's *Analysis*, participating departments have made a significant investment of resources in performance budgeting. We estimated approximately \$5 million worth of resources were invested by pilot departments through 1995-96.

Status of Pilot Program Is Unclear. In its evaluation report submitted to the Legislature in early 1996, the DOF indicated that it was premature to assess the project because it was still in the process of being implemented. However, it was not clear from this report as to when the project might be deemed complete, at which time it would be possible to evaluate the results as required by Chapter 641. In the case of the Department of General Services (DGS), legislation enacted subsequent to DOF's report stipulates that DGS' pilot project will conclude by July 1, 1999, and requires the DGS to submit a final report, presumably upon the completion of the pilot project, and recommend whether the DGS should continue performance budgeting on a permanent basis.

Why Limit Relief From Administrative Oversight to Only Pilot Departments? Since the inception of the pilot project, participating departments have been exempted from various administrative controls imposed by the DOF, the DGS, Department of Personnel Administration, and the State Personnel Board. The purpose of the exemptions was to free departments from unnecessary administrative controls so they could improve their performance. The extent to which exemptions from administrative control agencies have actually resulted in improved performance is unclear. In those cases where the exemptions have resulted in improved performance, it would make sense to extend them to *all* departments. Such exemptions would free departments from administrative controls which do not add value to state government, but entail excessive paperwork and impose delays on governmental processes.

Analyst's Recommendation. At one time, the administration indicated that the pilot project would be a necessary precursor to implementing performance budgeting on a statewide basis. Our review of the pilot departments indicates that despite the investment of significant resources in the pilot projects, it has been difficult for departments to quantify the benefits realized as a result of administrative flexibilities and relief from statutory requirements they received through annual budget contracts.

Other than the annual budget contracts, performance budgeting has not yet fulfilled its primary objective, which was to change fundamentally the state's budgeting process, nor is it clear that the pilot project has met other specific objectives outlined by the Governor when he established the pilot program. For these reasons, we recommend that the DOF advise the Legislature, during budget hearings, as to the status of the performance budgeting pilot project, the administration's future plans for performance budgeting, and the extent to which administrative flexibilities provided pilot departments should be provided to all state agencies.

Use of the Budget Bill to Specify Relief From Administrative Controls and Statutory Exemptions

We recommend that the Legislature not approve performance budget contracts in the form of budget bill provisions because these arrangements are more appropriately addressed through either separate legislation or written agreements between pilot departments and executive branch administrative agencies.

By law, performance-budgeting pilot departments are required to submit draft budget contracts to the Legislature's fiscal committees by January 31 of each year. The purpose of these contracts is to require departments to deliver identified outcomes for a specific level of funding. Frequently, these contracts propose to include in the budget bill provisions that relieve departments of various administrative controls that are established by statute, regulation, or other actions of the executive branch. Similarly, pilot departments have used the budget bill to obtain exemptions from various other requirements established by the Legislature in statute. Discussions with the Legislative Counsel's Office indicate that it is inappropriate to use the budget bill to obtain exemptions from various statutes, because substantive changes to the law must be made through separate legislation. With respect to relief from administrative controls, except for those which may be tied to budget bill control sections, there does not appear to be a good reason to clutter the budget bill with agreements that do not involve legislative policy.

Consequently, we recommend that budget contracts submitted to the Legislature not include provisions which should more appropriately be addressed through either separate legislation or written agreements between pilot departments and executive branch administrative agencies.

Freeze Performance-Budgeting Contracts Pending Demonstration of Improved Performance

We recommend that the Legislature not adopt additional administrative flexibilities for performance budget pilot departments because these departments have not demonstrated significant performance improvements as the result of exemptions provided to date.

The performance-budgeting pilot departments are proposing a number of changes to their budget contracts for 1997-98. Generally, these changes are statutory exemptions from various requirements, such as those requiring that positions vacant continuously between October 1 and June 30 be abolished. Another proposed change would allow departments to prepay vendors, which is currently prohibited. We are informed that several of the changes, included in each of the contracts, were included at the request of the DOF in an attempt to attain some level of consistency among the pilot departments' budget contracts.

While there is merit in consistency, in the absence of any demonstrated significant improvement in performance as the result of statutory exemptions already approved, the case for expansion has not been made. Moreover, we do not believe that it is appropriate to use the pilot project as a means to provide to a select few departments exemptions which might be beneficial for all state agencies. Consequently, while some of the proposed budget contract changes may have merit because they would remove or modify a statutory requirement which the Legislature might agree is no longer required, these are changes which, as noted above, we believe should be addressed through separate legislation.

As regards proposed changes to executive branch administrative controls, they should be handled within the administration, and do not require inclusion in a contract with the Legislature. Therefore, we recommend that the Legislature disapprove proposed changes to annual budget contracts with performance budget pilot departments.

How Much Will it Cost to Modify Computer Programs To Accommodate the Year 2000?

We recommend that the Department of Finance advise the Legislature during budget hearings as to the estimated cost to convert state computer programs to accommodate the "year 2000 change," and how this cost will be budgeted.

In our review of the Department of Information Technology (DOIT) in this *Analysis*, we discuss that department's efforts to provide guidance to state departments faced with the necessity of converting their computer

programs to accommodate the year 2000 change. Such a conversion is necessary for most of the state's computer programs which include a date reference because they were written to accommodate only years beginning with a "19." Consequently, such programs will not perform correctly—or at all—for calculations involving dates occurring after December 31, 1999, unless the computer code is corrected.

The problem of code conversion for the year 2000 is one being faced by governments and the private sector worldwide. It is important to address the issue now because many computer programs involve transactions with future dates, such as when a license will expire, when a contract must be paid in full, or when a structure must be inspected. In fact, some systems have already been affected because they compute dates occurring after December 31, 1999.

Substantial Conversion Costs Indicated. Preliminary indications are that the state's potential cost of conversion will be substantial. This information is coming from the few departments which have identified year 2000 conversion costs and sought budget augmentations. Based on these preliminary indications, we estimated in last year's *Analysis* that total state costs could exceed \$50 million. Some think that the actual cost may be closer to double that amount. The DOIT has surveyed state agencies as to their year 2000 conversion plans, and as part of its effort will assess the potential state cost. It is our understanding that the DOF has taken the position that, as a general rule, conversion costs should be absorbed. However, it has advised state agencies to submit budget augmentation requests no later than February 14, 1997 for conversion costs which an agency believes it is unable to absorb. According to the *Governor's Budget Summary*, the administration "... expects to evaluate and assess funding requests during the spring budget update."

Analyst's Recommendation. Given the urgency of the year 2000 conversion and the likelihood of a substantial increase in state expenditures in 1997-98 for conversion-related activities, we recommend that the DOF advise the Legislature during budget hearings as to the estimated cost to convert state computer programs to accommodate the year 2000, and how this cost will be budgeted.

Highlighting Information Technology Expenditures In the Governor's Budget

We recommend that the Legislature adopt supplemental report language directing the Department of Finance to display in the Governor's budget document, for each department, the total proposed expenditures for information technology, and separately identify any information technology project expenditure of \$1 million or more, by project title.

The DOIT estimates the state's annual expenditures for information technology at approximately \$2 billion. In addition, a survey conducted in 1995 by the Joint Committee on Information Technology in State Government, identified 28 state agencies that were in the process of developing information technology projects, each estimated to cost \$1 million or more, at a total estimated cost of \$2.3 billion. In addition, 11 agencies identified 11 planned new projects costing \$1 million or more each, with a total cost estimated to be \$124 million.

As indicated in various departmental budget reviews in this *Analysis*, state information technology projects continue to encounter significant implementation problems, and known deficiencies in the state's information technology infrastructure remain essentially unresolved. (Please see, for example, our analyses of the Department of Information Technology, California State Lottery Commission, Health and Welfare Agency Data Center, and Department of Corrections.) Moreover, as discussed in our review of DOIT, information provided to the Legislature regarding major information technology projects tends not to provide in many instances a clear understanding of important facts of these projects as required by Chapter 508, Statutes of 1995 (SB 1, Alquist).

One way to keep the Legislature better informed as to the state's information technology efforts is to display in the Governor's budget each department's total information technology expenditures, and all information technology project expenditures of \$1 million or more, by project title. This would highlight all projects for which an expenditure of \$1 million or more was made or proposed in any of these fiscal years addressed in the Governor's budget. Moreover, doing so would be consistent, we believe, with the special focus the Legislature placed on state information technology when it enacted major oversight reform in 1995. Moreover, highlighting costly information technology projects would facilitate the Legislature's understanding of the costs of a project over time. For all these reasons, we recommend the following supplemental report language:

The Department of Finance shall display for each organizational budget contained in the 1998-99 Governor's Budget, the total proposed expenditure for information technology, as well as any information technology project expenditure of \$1 million or more, by project title in any of the three fiscal years covered in the budget.



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 a force of 3,600, the department maintains a headquarters complex in Sacramento, 127 armories, 39 equipment maintenance facilities, 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 1997-98 Governor's Budget proposes expenditures of \$472 million by the department. Of that sum, \$444 million would come from the federal government, although only \$29.3 million would be appropriated through the budget bill. The budget bill would also authorize the expenditure of \$20.1 million from the state General Fund for the department, an increase of about \$1.2 million or 6.5 percent in the budget year. The balance of the request (\$7.4 million) is from reimbursements and a special fund.

Funding Increases Requested For Armory Maintenance and Repair

We recommend approval of \$846,000 and 24 positions requested from the General Fund to upgrade the maintenance of armories and air bases and to pay for increased security lighting costs. However, we recommend that the requested positions and a previously funded asset manager be provided for a two-year limited term. We also recommend approval of a proposed one-time \$1 million augmentation to repair and modernize National Guard facilities, but recommend the adoption of budget bill language directing that the General Fund appropriation be automatically reduced by any additional revenues received by the department from the sale or lease of surplus armories.

Because of growing concern that many of its armories are deteriorating and that some have inadequate lighting and other security, the Governor's budget provides \$846,000 from the General Fund to add 16 National Guard and 8 Air National Guard maintenance and repair staff, and provide more money for security lighting at armories. The budget also proposes a one-time expenditure of \$1 million to do electrical work, roofing, paving, plumbing, ventilation system repair, painting, and to make other improvements at deteriorating armories, many of which are 40 to 65 years old.

Funds Were to Come From Improved Asset Management. While we believe these proposals have merit, we are concerned that the major source of support for these budget proposals is the General Fund. In 1995, the department requested \$64,000 from the General Fund to establish an asset management program intended to facilitate the lease and sale of surplus armory property. In justifying its request to hire an asset manager at the time, the department indicated the new program would generate an additional \$600,000 a year for armory maintenance. Although efforts to lease or sell surplus armory property are under way, the asset management program has generated very little additional revenues.

We believe it is appropriate to continue the asset management program, at least until it has had sufficient time to achieve results. We have been advised by the department that the leasing of one department property is pending and might be completed in the budget year. We are also advised that additional revenues potentially ranging into the hundreds of thousands of dollars might be generated in ensuing years.

However, the department has expressed an interest in using future proceeds from sales and leases of its property to establish *new* armory facilities. Given the department's 1995 proposal to use such revenues for maintenance and repair of its *existing* armories, we believe the Legislature should instead adopt budget bill language directing that any such revenues be used to offset the General Fund augmentations it is now proposing.

Analyst's Recommendation. For these reasons, we recommend approval of the \$846,000 for staff to upgrade armory and air base maintenance and the \$1 million augmentation proposed to repair and modernize National Guard facilities. However, because we remain uncertain about the potential for the asset management program to recover the revenues needed to support these positions, we recommend that the requested positions as well as the asset management position be made two-year limited-term positions. If, after two years, the department has failed to generate additional revenues from the sale or lease of armory properties, the Legislature would have an opportunity to reconsider the funding of

these positions and whether the asset management function should be transferred to the Department of General Services.

We also recommend the adoption of budget bill language directing that the department's General Fund appropriation for armory maintenance be automatically reduced by any additional revenues received by the department through its asset management program.

Specifically, we recommend adoption of the following budget bill language:

To the extent that the Military Department receives revenues through its asset management program, and notwithstanding any other provision of law, the department shall expend those funds, in lieu of funds appropriated in this item, for armory and facility maintenance, repair, and modernization, and an amount of the appropriation made by this item equaling the amount of that expenditure shall revert to the General Fund.

Budget Plan Assumes Termination Of Homeless Shelter Program

A program under which the Military Department makes its armories available to cities and counties as emergency shelters for homeless persons during cold weather is set to expire on March 15, 1997, and the Governor's budget does not propose to extend it. We recommend that the Legislature consider enacting legislation to continue the program after it reviews a forthcoming evaluation.

Background. Chapter 1195, Statutes of 1994 (AB 1808, Areias) established a program by which the Military Department is required to make 25 specified armories in 16 California counties available to cities and counties as emergency shelters for homeless persons during certain periods of cold weather. As provided under Chapter 1195, the program expires on March 15, 1997. The measure also required that prior to this expiration date the Departments of the Military, Housing and Community Development, and Economic Opportunity (since renamed Community Services and Development), prepare a joint evaluation of the effectiveness of the program and the progress of participating counties and cities to develop long-range shelter programs for homeless persons.

Budget Assumes Program Will Expire. The Governor's budget assumes the program will not be extended and accordingly would reduce the department's budget to eliminate the \$630,000 that would be required for its continuation. Such funding has been provided in prior years to offset the costs to the department of the program, such as the need for additional security for its property.

The department is not seeking legislation to continue the program. The department believes that, because of security and other problems created by the presence of homeless persons at its facilities, it is inappropriate to use armories as emergency shelters.

Many Communities Still Lack Alternative Shelters. Although Chapter 1195 provided that use of the armories as shelters was to be a temporary measure until cities and counties developed alternative shelter arrangements, we are advised by the Departments of the Military and Community Services and Development that many communities still have no alternative shelter site available for the homeless. The armories have been providing emergency shelter for more than 191,000 persons annually.

Analyst's Recommendation. Although we acknowledge that the program has created some operational difficulties for the Military Department, we believe the relatively small state cost of the program—about \$3.28 for each person who receives shelter—merits consideration of continuing the program. For this reason, we recommend that the Legislature, following its review of the forthcoming evaluation, consider enacting legislation to continue the program. If the Legislature chooses to enact such legislation, it would need to augment the Military Department's budget by \$630,000 from the General Fund to provide the necessary financial support.



DEPARTMENT OF VETERANS AFFAIRS AND VETERANS' HOMES OF CALIFORNIA (8950-8965)

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 veterans' homes in Yountville and Barstow with several levels of medical care, rehabilitation services, and residential services.

The budget proposes total expenditures of \$355 million for the DVA in 1997-98. This is \$8.6 million, or 2.4 percent, less than the estimated current-year expenditures. Total expenditures from the General Fund during the budget year would be \$40.1 million, which is \$1.7 million, or 4.5 percent, more than the estimated current-year level.

The decrease in the overall budget reflects significant decreases in the Cal-Vet farm and home loan program that are largely offset by the significant additional costs of bringing the new veterans home at Barstow to full capacity and proposed staffing increases at the Yountville facility.

General Fund Share for Support For Yountville Again Rising

State General Fund support for the Yountville veterans' home has begun to rise, reversing a pattern by which federal funds and reimbursements had been providing an increasing share of the support for its operations. Efforts to better contain the home's operating costs are under way but have not yet proven effective.

The Veterans' Home of California, which has been operating at Yountville in Napa County since 1884, provides five levels of medical and

residential care for about 1,140 veterans. Specifically, it provides: (1) an acute care hospital for residents requiring significant medical services; (2) a skilled nursing facility (SNF) providing assistance in daily living, nursing, and therapy; (3) an intermediate care facility (ICF) providing both less living assistance and a minimal level of nursing care; (4) residential care in which minimal living assistance is provided; and (5) domiciliary care in which residents are fully self-sufficient.

The home is operated with a combination of funding sources, including Medicare and Medi-Cal reimbursements for medical and nursing services, aid and attendance allowances from the U.S. Department of Veterans Affairs (U.S. DVA), fees paid by home residents, and the General Fund.

Collection of Reimbursements Has Improved. Following significant cuts in the Yountville home's budget in 1992-93, the Legislature directed the DVA to improve its efforts to collect reimbursements from the federal government and other sources and thus lessen the financial burden of the home on the General Fund. A 1994 audit by the Bureau of State Audits (BSA) determined that the home might collect several million dollars in additional revenues through improved collection procedures and policy changes which could reduce the General Fund cost of operating the facility.

Partly due to the efforts of the home, but also partly due to cost-of-living increases provided by Congress for U.S. DVA veterans' assistance programs, the amount of reimbursements and federal funds generated by the home has been on the rise. From 1993-94 through 1997-98, these funding sources are anticipated to grow by more than \$5.4 million, or almost 25 percent.

General Fund Share Had Declined. Initially, reductions made in the support budget of the home and improvements in the collection of federal funds and reimbursements meant that the home was less dependent than it had been on the General Fund. The General Fund share of home support decreased from 53 percent in 1992-93 to 46 percent in 1995-96 in keeping with the DVA's own stated goal of reducing the share of financial support it receives from the General Fund.

That pattern has reversed slightly since 1995-96 so that the home is once again becoming more dependent on General Fund support. Under the 1997-98 Governor's Budget proposal, the General Fund would pay 47 percent of the cost of operating the home. The pattern is the same for each level of care provided at the home. Because the DVA plans to open remodeled nursing wards at the Yountville home during 1998-99 at a

potential cost of more than \$4 million, we are concerned that the General Fund share will go even higher.

Operating Costs Growing Faster Than New Revenues. The reason that General Fund support is increasing is that the costs of operating the home are growing faster than new revenues. While federal funds and reimbursements are projected to increase by \$1.4 million from 1995-96 through the budget year, home operating costs would go up \$3.8 million during that time.

A comparison of the veterans' home with other nursing homes and hospitals suggests that Yountville's operational costs are high. For example, the average cost per day of operating a bed in Yountville's acute-care hospital in 1996-97 is projected to be \$1,691. That is almost double the average rate of \$923 to be paid to California hospitals under the Medi-Cal program. Similarly, while the SNF unit at Yountville is projected to cost \$242 per bed for each day of operation, other nursing facilities are paid \$215 daily for the same services.

Even though the budget for its operations is relatively high, the Yountville veterans' home has had difficulty this last year managing to stay within its budgeted level of expenditures. At the end of the 1995-96 fiscal year, the Director of Finance advised the Legislature that he was augmenting the budget of the veterans' home with \$1 million in additional federal funds and reimbursements that was available because the home had overspent its budget for that year without prior notice or approval from the Legislature. At the time, the home indicated it was struggling to address cost increases for workers' compensation claims, overtime and temporary help personnel costs, pharmacy, and other costs.

The Legislature agreed to carry over \$780,000 of the \$1 million augmentation into the current-year budget but adopted budget act language directing that the DVA report to the Legislature on its efforts to better control its costs. After completing a "zero-based budget" review of Yountville operations, however, the DVA has not proposed ways to cut its costs but has instead requested a \$1.4 million augmentation—funds which would be added to the prior \$780,000 previously included in its operating budget. We discuss this latest augmentation request later in this analysis.

Bureau of State Audits Recommends Major Changes in Yountville Operations

The Bureau of State Audits (BSA) has recommended significant operational changes in the Yountville home that could eventually save the state more than \$7 million in General Fund support for the facility. We recommend the adoption of five BSA proposals that would result in an

estimated \$1.6 million in annual General Fund savings in the Yountville budget. We also recommend that the BSA and the Department of Veterans Affairs report at budget hearings regarding how other BSA proposals that could produce long-term savings should be implemented.

The 1996-97 Budget Act directed the BSA to conduct a comprehensive fiscal and performance audit of the Yountville home in order to determine whether the home appropriately manages its medical operations. The budget act directed the BSA to examine, in particular, whether the home was being operated under a managed care approach that would ensure high-quality medical care while minimizing the cost of that care.

The BSA analyzed Yountville home operations with the assistance of a private-sector consultant on managed care issues and released its report on January 29, 1997. The report concludes that the home could take steps to decrease its costs and increase revenues while improving the quality of care for patients. The report raised serious concerns about the operation and management of the home, especially in regard to the cost of the acute care and nursing facilities, and offered a series of recommendations to address those issues.

We believe some BSA proposals, and in particular the five we discuss below, can be implemented within the budget year. Other BSA proposals, in our view, either require intermediate actions that would probably delay their implementation until after 1997-98 or require further review.

Immediate Action Warranted. We have reviewed the BSA report and believe that five of its cost-saving recommendations should be implemented in the 1997-98 budget year. These BSA recommendations are as follows:

- Eliminate three staff physician positions to remedy overstaffing of Yountville medical facilities. The BSA concluded that the Yountville home had too many physicians on its staff, uses physician staff time inappropriately, and that a reduction in physician staffing would result in net savings of more than \$400,000 to the state.
 - Contract out the home's laundry services. Based on the results from contracting out these services at the state's Barstow veterans home, the BSA found that elimination of service staff assigned to the laundry at Yountville, and contracting with the Prison Industry Authority or a private firm to provide these services, would save the state \$350,000 annually.
 - Realign the nursing staff so that *more* nursing services are provided through less costly licensed vocational nurses and nurses' aides
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and fewer nursing services are provided through more costly registered nurses. The BSA estimates that maximizing this approach would save the state about \$816,000 annually.

- Initiate a study weighing the costs and benefits of closing the acute care hospital and contract for more hospital care in nearby community hospitals, among other alternatives. (In the interim, the BSA suggests that the Legislature could reduce the acute care hospital budget to be more in line with average medical industry costs.) The BSA estimates that savings of at least \$854,000 annually could eventually be achieved.
- Initiate a study of patient needs to determine if the number of SNF beds could be reduced and, if it proved necessary, ICF beds increased. For illustrative purposes only, pending completion of such a study, the BSA estimated savings of \$1 million annually.

Thus, adoption of these five BSA proposals could initially reduce the Yountville home budget by about \$1.6 million annually from the General Fund but generate additional one-time costs for studies, probably in the hundreds of thousands of dollars. We are continuing our review of the BSA recommendations to determine if there are other proposals that the Legislature could implement in the short-term.

Other Proposals Deserve Discussion. As discussed above, some of the BSA proposals to revamp Yountville home operations require either further study or intermediate steps before they could be implemented. Among these proposals:

- License a home health care agency at the home, a procedural step that would enable some patients to receive limited nursing services at less cost in their residences instead of a nursing ward. The BSA did not estimate the savings from this proposal.
 - Contract out dietary services to an outside vendor at an estimated savings of \$2 million annually.
 - Reduce nursing salaries to California averages through new collective bargaining agreements for an estimated savings of \$1.8 million annually.
 - Scale back the number of SNF beds officially designated for Medicare patients, a procedural change that could increase the amount of Medicare funds reimbursed to the state. The BSA did not estimate the resulting additional revenues.
 - Move two separate SNF facilities to a common area to increase efficiency. The BSA did not estimate the savings for this proposal.
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We will continue to review the merits of these proposals. Because of their complexity and the need to safeguard the health care of the veterans who reside at the home, the Legislature should carefully consider how these and other BSA proposals resulting from the audit should be implemented.

Analyst's Recommendation. For these reasons, we recommend adoption of the five BSA recommendations listed above and also recommend that the BSA and the DVA report at budget hearings regarding how these and other BSA proposals that could produce savings after 1997-98 should be implemented.

Yountville Augmentation Request Should Be Modified

We recommend that a \$1.4 million budget augmentation for the Yountville veterans' home be reduced to \$1.3 million and modified as follows: (1) delete funding and two personnel-years requested for additional pathology staffing, (2) adopt supplemental report language to ensure a \$550,000 telecommunications project is proven cost-beneficial before it commences, and (3) switch the funding source for at least \$400,000 of the augmentation from the General Fund to federal funds and reimbursements the home is likely to receive but has not allocated in its budget. The Department of Veterans Affairs should report at budget hearings on the availability of additional funding from these sources to offset the request for increased General Fund support. (Reduce Item 8960-011-0001 by \$499,000 and increase federal funds and reimbursements by \$400,000.)

Based upon a "zero-based" review of its budget, the DVA is requesting an augmentation of \$1.4 million and 27.6 personnel-years, including \$550,000 from the General Fund and about \$890,000 from anticipated additional federal funds and reimbursements. The DVA states that the augmentation is needed to "adequately fund" the home. Specifically, the DVA is requesting additional positions and funding related to 11 different services or operations at the home, including alcohol and drug treatment, security, sanitation, social work, telecommunications, and various administrative functions.

We have reviewed the request in light of our concerns about the growth of General Fund cost of the Yountville home and the findings of the BSA, both discussed above. We believe most of the DVA requests are reasonable but that one should be rejected, another modified, and the sources of funding revised.

Pathology. The budget requests two laboratory technicians and \$99,000 for increased laboratory workload. We recommend denial of this request because it is not justified on a workload basis. We note that the BSA audit found that the home's pathology services cost 13 times the state average. This funding would not be needed if in-house pathology services were contracted out as the BSA has proposed.

Telecommunications. The budget requests \$550,000 to install cabling and wiring for a new telephone system and infrastructure for a new Veterans Home Information System (VHIS) Yountville.

We support the funding request because an improved data system is critical to improving the home's collection of reimbursements and implementing other reforms proposed by the BSA. However, we recommend the adoption of budget bill language directing the DVA to delay expenditure of these funds until it (1) has completed and received the necessary approval of other state agencies of a feasibility study report justifying the cost-benefit of the VHIS project, including the \$550,000 in costs provided in the budget request, and (2) the DVA has validated that the Barstow VHIS, the technology upon which the Yountville system would be based, is working as planned. These steps will help the Legislature ensure that the \$550,000 is spent appropriately.

Specifically, we recommend the following budget bill language:

Of the amount appropriated in this item, \$550,000 shall be available for cabling and wiring for a new telephone system and information systems infrastructure for the Veterans' Home of California at Yountville. These funds shall not be expended until (1) the Department of Veterans Affairs has completed a feasibility study report justifying the cost benefit of the Veteran Home Information System (VHIS) project, including the \$550,000 in cabling and wiring costs provided in this item, and obtained the necessary approvals from the Department of Information Technology and the Department of Finance, and (2) the Department of Veterans Affairs has validated the VHIS at the Veterans' Home of Southern California at Barstow is working as planned.

Funding Shift. We are advised that the Yountville home is likely to receive at least \$200,000 in additional federal reimbursements for pharmacy costs incurred by the home. In addition, based upon the Clinton Administration's proposed 1998 federal budget, we believe it is likely that the federal government will again increase funding for medical care and veterans benefits provided by the U.S. DVA. We estimate this will generate at least an additional \$200,000 in revenues to the home during the budget year. Neither the pharmacy nor the U.S. DVA funds have been allocated in the Governor's budget proposal for the Yountville home. This

money could be used to partly offset the requested General Fund augmentation.

Analyst's Recommendation. Accordingly, we recommend that the \$1.4 million augmentation be reduced by \$99,000 and modified as described above with the adoption of budget bill language. Also, the DVA should report at budget hearings as to the additional funding it projects will be available from pharmacy reimbursements and other federal veterans programs to offset the requested General Fund augmentation.

Occupation of Barstow Home Again Falls Behind Schedule

We withhold recommendation on \$17.2 million budgeted for the operation of the Barstow veterans' home pending receipt of updated population estimates at the time of the May Revision and a report by the Department of Veterans Affairs at budget hearings on the applicability of the Yountville audit findings to the Barstow home and the potential availability of additional federal funds to offset General Fund expenditures.

The Veterans' Home of Southern California, located at Barstow in San Bernardino County, opened in February 1996 with 220 domiciliary care beds, a 120-bed SNF, and a 60-bed ICF. Since its opening, the DVA has had difficulty finding residents to occupy the facility and the scheduled date of full occupancy has slipped repeatedly.

The 1995-96 budget for the home was based upon the assumption that nearly all of the beds would be filled by October 1996. The DVA later revised that date to December 1996, and the Barstow home was budgeted on that basis. As of January 1997, however, the home had filled only about 150 of its 400 beds. The 1997-98 budget proposal for the Barstow home assumes that it will reach full occupancy by December 1997.

Barstow Home Has Been Overbudgeted Every Year. The delays in the timetable for occupying the home have had two significant consequences.

First, the delays have led to significant overbudgeting of the Barstow facility for two years in a row. Fewer staff than scheduled have been brought on line and other expenditures slowed because there were far fewer veterans to serve at the new facility than expected. The *1995-96 Budget Act* initially allocated \$5.4 million more to the home than was needed. It now appears that the *1996-97 Budget Act* initially provided the Barstow home with at least \$4.3 million more than is needed, and that figure could go higher.

The continued shortfall in residents has had a second significant impact: It has made it much more expensive to provide services to those residents who did move to the Barstow facility. Many Barstow home costs, such as maintenance of the grounds, remain the same regardless of the number of residents who live there. If fewer residents move to the home, the average cost of the services is higher than would otherwise be the case.

As a result, each SNF bed occupied at Barstow during 1996-97 is now estimated to cost an average of \$173,000 a year to operate—more than double the cost of a similar bed at Yountville. An ICF bed at Barstow is expected to have an annual operational cost of \$143,000 compared to the \$58,000 annual cost at Yountville. Likewise, a domiciliary bed at Barstow is projected to cost \$25,000 annually to operate, compared to the \$18,000 cost at Yountville's domiciliary.

We are advised by the DVA that the cost estimates discussed above may be revised downward as the fiscal year progresses. However, even if they are revised, it appears likely that the costs of operating Barstow will remain high. The average cost of operating the Barstow facility is projected in the Governor's budget to drop substantially during 1997-98. However, that projected drop in costs assumes that the DVA's latest projection of steady population increases at Barstow is accurate.

BSA Audit Findings Should be Considered at Barstow. Although the BSA audit discussed in this Analysis did not involve a review of operations at Barstow, we believe that several BSA recommendations could be applied to the newer home. These include proposals that change the mix of nursing staff, the proportion of beds between SNF and ICF, the establishment of a home health agency, and scaling back the number of SNF beds officially designated for Medicare patients to increase federal reimbursement rates.

We would also note that the federal veterans' program funding increases proposed in the Clinton Administration's 1998 federal budget proposal should generate at least \$80,000 in additional funding for support of the Barstow home. The General Fund support requested for the home should be adjusted downward to reflect the availability of these funds. The DVA should report at budget hearings on the availability of these funds to reduce the General Fund appropriation.

Analyst's Recommendation. In order to ensure that the Barstow home is not overbudgeted for the third year in a row, we withhold recommendation on the Barstow home budget pending the receipt of updated population growth projections for the facility and a corresponding adjustment of the 1997-98 budget request at the May Revision. We also recom-

mend that the DVA report at budget hearings regarding the applicability of the Yountville audit findings to the Barstow home operations and the availability of additional federal funds and reimbursements available to reduce the amount of General Fund resources budgeted for the home.

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VETERANS MEMORIAL COMMISSION (8975)

The Veterans Memorial Commission is composed of nine members appointed by the Governor, the Speaker of the Assembly, and the Senate Rules Committee. The panel is authorized to raise and expend funds, including contributions from private donors as well as those received from a check-off on state income tax forms, to build a Veterans Memorial on the grounds of the State Capitol.

The Veterans Memorial Commission does not appear in the budget bill. This is because the Veterans Memorial Account, into which any contributions are transferred, is continuously appropriated without regard to fiscal year. The commission estimates that it had cash on hand and deposits of about \$400,000 as of November 30, 1996.

Memorial Fund-Raising Progressing Slowly

Because the commission advises that the memorial will be completed by January 1, 1998, we recommend enactment of legislation to abolish the commission as of that date. Because the success of fund-raising efforts remains in doubt, we recommend that the legislation provide for a transfer of any assets that remain as of that date to an appropriate private or public program that would benefit or memorialize the efforts of California veterans.

The Veterans Memorial Commission was created in 1985 to raise private donations to build a memorial to all California war veterans. In 1991-92, \$700,000 in surplus funds that had been raised to build the Vietnam veterans memorial was transferred to the commission to assist with the construction of the new memorial to all California war veterans. That same fiscal year, the Legislature enacted Chapter 481, Statutes of 1991 (SB 1029, Rogers) to establish a check-off to the state income tax form to raise additional contributions from taxpayers for the new memorial. The tax check-off provision was to expire at the end of 1996, but Chapter 960, Statutes of 1996 (AB 2955, Knight), extended the tax check-off provision to the end of 1997.

History of Fund-Raising Problems. In last year's *Analysis*, we noted that after five years of extensive fund-raising activities and repeated assurances to the Legislature that the project was near completion, the memorial construction account had less than half the money that was available in the fund when efforts began and the commission was far short of its then -\$1.2 million goal.

A 1994 Department of Finance audit found that the commission expended hundreds of thousands of dollars on fees for private fund-raising consultants, direct-mail fund-raising solicitations, administrative costs, and one staff position with little or no return in contributions to the memorial construction fund. We concluded last year that the commission would have achieved its fund-raising goal had it simply set aside the surplus funds received from the Vietnam veterans memorial and the tax check-off, invested the funds in the state's Pooled Money Investment Account, and engaged in no fund-raising activity of its own. As a result, we recommended last year that the commission be disbanded and any remaining proceeds be transferred to another project that would benefit California veterans.

In response to legislative concerns, the commission redesigned its project to lower its cost to \$1 million, successfully sought state legislation to continue the expiring state tax check-off another year, and presented the Legislature with a revised fund-raising plan which provided that the fund-raising would be completed in December 1996. In light of those assurances, the Legislature agreed to retain the commission.

Commission Fails to Meet Goals. Our analysis of the commission's performance over the past year indicates that it has made some progress in obtaining cash and in-kind contributions to the memorial project. Moreover, the commission has again redesigned the project to lower its cost to about \$850,000, a fund-raising goal that would be easier for it to achieve. Nonetheless, the contributions obtained by the commission this year fell short of what is needed and completion of the project remains in doubt.

Figure 13 (see next page) shows how the contributions received by the commission compare to the \$1 million fund-raising goal presented to the Legislature last spring. Although all commission fund-raising was supposed to have been completed in December 1996, the commission remained about \$588,000 short of the contributions needed for the project as of November 30, 1996, and appeared unlikely to close that gap in December 1996. After adjusting for the latest cost reduction, the commission remains about \$375,000 short of the contributions needed to complete the project.

Figure 13

**Veterans Memorial Commission
Commission Fund-Raising Has Not Met 1996 Goals**

Funding Source	Goal	Actual
Beginning fund balance	\$410,000	\$397,000
Small donor program	5,000	450
Sale of granite benches	125,000	40,000
Sale of flagstones	50,000	16,000
Major donors—flagpoles	150,000	—
Major donor—granite boulders	50,000	—
In-kind—construction supervision	5,000	5,000
In-kind—contract management	10,000	—
In-kind—project management	15,000	15,000
In-kind—computer registry	50,000	—
In-kind—sitework	73,000	—
In-kind—concrete	9,000	—
In-kind—electrical	109,000	—
Totals	\$1,061,000	\$473,450
Fund-raising shortfall		\$587,550

Because the commission has repeatedly presented the Legislature with fund-raising timetables that it has failed to meet, we are uncertain whether even the new, lower fund-raising goal for the project can be achieved. In any event, the commission has assured us that it will complete its fund-raising campaign, as well as construction of the veterans memorial itself, by December 1997.

Analyst's Recommendation. For these reasons, we recommend the enactment of legislation to abolish the commission as of January 1, 1998—the same date that the authority for the state tax check-off for the commission will expire. By that date, the commission will either have succeeded in its fund-raising activities for the project or it will not have.

We recommend that such legislation establish ongoing resources to maintain the memorial in the event that the project is successful. In any event, the legislation should direct the California Veterans Board (which now includes as a member the Secretary of Veterans Affairs), to provide the Legislature with a recommendation as to an appropriate recipient of any funds held by the commission at its termination.

Because the funds held by the commission originated from charitable contributions, we recommend that they be used for another project that would benefit or memorialize the efforts of California veterans after the California Veterans Board has had an opportunity to present the Legislature with a recommendation.

We can suggest two such projects that might be considered. For example, any funds left over from the memorial project might be used to renovate a deteriorating 106-year-old cemetery near the California Veterans' Home at Yountville, which the Department of Veterans Affairs estimates needs nearly \$650,000 in repairs. Or, the Legislature may instead wish to redirect any leftover funds to a long-pending project to beautify and enhance the existing California Mexican American Veterans' Memorial across the street from the State Capitol.

Chapter 1221, Statutes of 1993 (AB 1350, Polanco) provides authority to establish a Mexican American Veterans' Memorial Commission along with a new state income tax check-off to assist in fund-raising efforts. However, the statute provides that such work cannot commence until the new memorial to all war veterans has been built on the grounds of the Capitol. If the Legislature wishes for the commission to be formed and for fund-raising to proceed, it may wish to amend state law to remove that requirement and allow the project to advance.



HEALTH AND DENTAL BENEFITS FOR ANNUITANTS (9650)

This appropriation provides for the state's contribution toward 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 annuitants the option of selecting from 20 state-approved health plans (depending on where an annuitant lives).

Budget-Year Costs Are Uncertain

We withhold recommendation on the \$278.7 million General Fund request for Health and Dental Benefits for Annuitants pending final determination of premium rates for calendar year 1998.

The budget proposes total expenditures of \$278.7 million from the General Fund for health and dental benefits for annuitants in 1997-98. This is \$10.7 million, or 4 percent, more than estimated expenditures for this purpose in the current year, reflecting an increase in the number of annuitants and no change in premium rates. Figure 14 displays General Fund expenditures for annuitant health and dental benefits for the three fiscal years starting with 1995-96. Although these costs are initially paid from the General Fund, the state recovers a portion of these costs from special funds (about 33 percent) through pro rata charges.

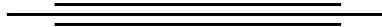
The actual amounts needed in this item, however, are dependent on negotiations over health premiums currently underway between the state and providers. The Governor's budget indicates that premium rates for the second half of the budget year are currently under negotiation. Hopefully, these negotiated premium rates will be available for review during legislative budget hearings. Pending receipt of these rates, we withhold recommendation on the amount requested under this item.

Figure 14

**Health and Dental Benefits
For Annuitants
General Fund
1995-96 Through 1997-98**

(In Thousands)

Program	1995-96 Actual	1996-97 Estimated	1997-98 Budgeted
Health	\$238,188	\$238,257	\$247,787
Dental	\$28,869	\$29,734	\$30,923
Totals	\$267,057	\$267,991	\$278,710



CONTROL SECTION 3.60

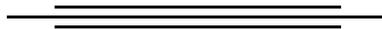
Public Employees' Retirement System Employer Contribution Rates

We withhold recommendation on employer contribution rates for retirement benefits pending (1) final determination of the actual rates to be applied in the budget year and (2) receipt and review of information regarding the actuarial assumptions underlying the 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 to adjust any appropriation in the budget bill as required to conform with changes in these rates. In addition, the section requires the State Controller to offset these contributions with any 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 1997-98 rates and receipt and review of information from the PERS regarding the actuarial assumptions underlying the determined rates. This information is typically available in March or April.



TAX RELIEF (9100)

The state provides local property tax relief, both as subventions to local governments and as direct payments to eligible taxpayers, through seven different programs. The two largest are the Homeowners' Property Tax Relief (homeowners' exemption) and the Renters' Tax Relief (renters' credit) programs.

As required by the state Constitution, the homeowners' exemption grants a \$7,000 property tax exemption on the assessed value of owner-occupied dwellings, and requires the state to reimburse local governments for the resulting tax loss. The exemption reduces the typical homeowner's taxes by about \$75 annually. This is the amount that otherwise would be owed on the \$7,000 exemption at the statewide average property tax rate of 1.06 percent (including debt levies). The Governor's budget proposes an expenditure of \$405 million on this program in 1997-98.

The renters' credit provides a refundable tax credit to Californians who rent their principal place of residence as of March 1 each year. The credit is applied first to income taxes due, with any balance paid directly to the renter as a refund. Persons with no income tax liability must file a return to receive the tax relief payment. The amount of the credit is \$60 for single renters and \$120 for married couples or heads of households. The renters' credit program was suspended for three years, beginning in 1993, as one of many spending reductions enacted to address the state's budgetary problems. The program was suspended for an additional year as part of the 1996-97 budget agreement, and was reinstated beginning on January 1, 1997. The Governor's budget, however, proposes eliminating this program effective January 1, 1997. The estimated cost for this program if it were not altered or discontinued in 1997-98 would be approximately \$525 million.

BACKGROUND

The homeowners' exemption and renters' credit were established to mitigate rapidly rising property taxes in the late 1960s and early 1970s. The homeowners' exemption was established by Proposition 1A in 1968 to provide homeowners with direct property tax relief. Recognizing that renters also pay property taxes indirectly through rental payments, the Legislature simultaneously passed companion legislation which extended tax relief, primarily to renters. Specifically, this legislation, Chapter 1, Statutes of 1968 (SB 8, Miller), doubled the personal income tax standard deduction, which most renters use to calculate their income tax liabilities. This legislation was contingent upon the voters' passage of Proposition 1A, establishing the homeowners' exemption.

The renters' credit as it exists today was one element of a comprehensive property tax reform package, Chapter 1406, Statutes of 1972 (SB 90, Dills). Among other changes, this legislation increased the homeowners' exemption to its current level (\$7,000) and placed limits on property tax rates. It also created the renters' credit by establishing specific credits which renters could use to reduce their income tax liability.

Proposition 13 Has Reduced The Need for General Property Tax Relief

The original renters' credit and homeowners' exemption were established during times of rapidly rising property tax liabilities. However, as we have indicated in previous analyses, the passage of Proposition 13 in 1978 has significantly reduced the need for general property tax relief. Both homeowners and renters have benefited from the reductions in property taxes resulting from the measure, which limits the property tax rate to 1 percent and limits the maximum allowable annual rate of increase in assessed value to 2 percent.

As a result of Proposition 13, property tax liabilities have dropped significantly. For instance, just prior to the passage of the proposition in 1977, Californians paid 5.5 percent of their total personal income in property taxes. Today, that figure is about 2.5 percent. Consequently, it is unclear why the state needs to continue to provide additional property tax relief through the renters' credit and the homeowners' exemption. While the former can be eliminated through statute (as proposed by the Governor), the latter would require a constitutional amendment approved by the voters.

OTHER CONSIDERATIONS

While the renters' credit program was created to provide property tax relief, it is often viewed in the context of general tax relief. The renters' credit is primarily claimed by low- and moderate-income taxpayers. According to projections for the 1997 tax year, three-fourths of those eligible to claim the credit will have less than \$30,000 in annual income (see Figure 15) and nearly one-third will have less than \$10,000 in annual income.

Figure 15		
Renters' Credit Claimants by Income^a		
Adjusted Gross Income	Number of Returns (In Thousands)	Percent Of Total
Less than \$10,000	1,786	30.9%
\$10,000 to \$20,000	1,491	25.8
\$20,000 to \$30,000	1,060	18.3
\$30,000 to \$40,000	649	11.2
\$40,000 to \$50,000	380	6.6
More than \$50,000	419	7.2
Totals	5,785	100.0%

^a Based on projections for the 1997 tax year.

Given the income of those eligible to claim the renters' credit, many have come to view this program as a means for easing the tax burden of lower-income residents of the state. In fact, the Legislature and the Governor recognized this aspect of the renters' credit program in 1991 and 1992. In order to limit spending, the credit was modified by making higher-income renters ineligible.

In deciding how to respond to the Governor's proposal to eliminate the renters' credit, the Legislature faces a difficult calculus. On the one hand, this program (along with the homeowners' exemption) can be viewed as it was originally intended—as property tax relief. In this case, it is no longer needed.

If, however, the renters' credit is viewed outside of this context and considered as an issue of general tax relief, the Legislature will have to make its decision with consideration of a variety of factors:

- **The Existing Allocation of Tax Burden Across Income Classes.** Eliminating the renters' credit would result in an increase in the tax liabilities for those typically lower-income individuals who are currently eligible to claim the credit.
- **How That Burden Would Change, Based on the Elimination of the Renters' Credit and the Potential Implementation of the Governor's Other Tax Proposals?** In addition to the elimination of the renters' credit, the Governor has proposed a reduction in corporate income taxes.
- **The Relative Treatment of Homeowners and Renters.** In addition to the homeowners' exemption, homeowners benefit from reduced state and federal income taxes as a result of the deductibility of property taxes and mortgage interest. Renters do not receive similar preferences.

Thus, in making its decision on the renters' credit, the Legislature should consider what purpose the program serves and how this program fits in with the overall allocation of the tax burden. Finally, if the Legislature wishes to provide assistance to lower-income residents of the state, an alternative program with more focused objectives and delivery mechanisms may be more effective. For example, the Legislature may want to consider using the money that would otherwise go for the renters' credit and instead supplement efforts designed to improve the welfare system or other state programs that benefit lower-income residents. Alternatively, the Legislature may want to consider other programs such as a state earned income tax credit or other tax incentives to promote work among lower income residents of the state. (Please see our *Perspectives and Issues*, Part V for a discussion of the Earned Income Tax Credit.)



LOCAL GOVERNMENT FINANCING (9210)

This budget item contains appropriations to local governments for three purposes:

- **Citizen's Option for Public Safety.** Last year the Governor and the Legislature created the Citizen's Option for Public Safety (COPS) program which provides \$100 million to local governments for law enforcement. The COPS program is discussed in more detail below and in Part VI of the *Perspectives and Issues*.
- **Special Supplemental Subventions.** This program reimburses qualifying redevelopment agencies for revenues lost as a result of the repeal of the business inventory exemption subvention.
- **State-Mandated Local Programs.** This item includes funding to reimburse local governments for costs incurred in complying with certain state-mandated programs.

The *1997-98 Budget Act* does not include funding for the property tax administration loan program, created by Chapter 914, Statutes of 1995 (AB 818, Vasconcellos). This program makes \$60 million in loan funds available to counties for property tax administration. These loans may be forgiven if counties can demonstrate that they have generated or preserved sufficient property tax revenue for schools to offset the costs to the state of the loan. When the loans are forgiven, a cost is accrued in Item 9210. The budget recognizes a cost for 1996-97 of \$48 million for this purpose. No funding is included for 1997-98, although costs of approximately \$50 million likely will be incurred as loans are forgiven.

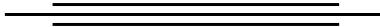
Citizen's Option for Public Safety—COPS

We recommend the Legislature reconsider its goals for this program. If the Legislature's primary goal is to augment local public safety efforts, we recommend that the Legislature redirect the proposed \$100 million to a public safety program that is more clearly targeted to achieving specific statewide objectives. Alternatively, if the Legislature's goal is to

provide local fiscal relief, we recommend the Legislature create a simple, direct program that provides maximum flexibility to local government.

Last year the Legislature enacted Chapter 134 (AB 3229, Brulte), creating the Citizen's Option for Public Safety Program—COPS. Under this program, counties and cities receive state funds, on a population basis, to augment public safety expenditures. The *1996-97 Budget Act* (Item 9210) provided \$100 million (General Fund) for COPS. The *1997-98 Governor's Budget* proposes to continue this same level of program funding.

As we discuss more fully in Part VI of the *Perspectives and Issues*, we recommend that the Legislature reconsider its goals for this program. If the Legislature's primary goal is to augment local public safety expenditures, we recommend that the Legislature redirect the proposed \$100 million to another public safety program that is more clearly targeted to achieving specific statewide objectives. Alternatively, if the Legislature wishes to provide local fiscal relief, we recommend the Legislature provide this relief in a more direct fashion. Among its options for providing such fiscal relief, would be to reduce the amount of property taxes local governments are required to transfer to schools.



FINDINGS AND RECOMMENDATIONS

General Government

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Crosscutting Issues

State Audit Programs

1. **State Audit Programs.** Recommend that the Legislature not approve \$18.9 million and 145 positions for the Board of Equalization (BOE) and Franchise Tax Board (FTB) that are requested, for the most part, on the basis of potential revenue benefits or losses because the Legislature does not have sufficient information to review the validity of the methodology used by BOE and FTB to make revenue impact calculations. We further recommend that BOE and FTB submit a report to the Legislature, evaluating the revenue impact of previous audit program augmentations. G-11

Employee Compensation

2. **New Collective Bargaining Agreements Still Under Negotiation.** The Department of Personnel Administration should report to the budget committees during budget hearings on the administration's collective bargaining proposals and the status of negotiations. G-20
3. **Strengthen Legislature's Collective Bargaining Oversight.** Recommend that the Legislature adopt policies to assure that the Legislature will have the opportunity to fully review proposed collective bargaining agreements. G-21

Department of Insurance

4. **Budget Changes in the Current Year and Budget Year Are Unexplained.** Recommend that the Legislature not approve the Department of Insurance budget until com- G-24
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plete information on the department's changes in the current year and budget year are available for legislative review.

California State Lottery Commission

5. **Magnitude of Administrative Expenditures Has Impact on Education.** Recommend that the Legislature amend the Lottery Act to provide for legislative oversight and appropriation of the commission's administrative expenses. G-27
6. **Budget Should Be Submitted for Legislature's Review.** Recommend that hearings be held on the commission's proposed 1997-98 budget and that an informational item be added to the budget bill, identifying planned budget-year administrative expenditures. G-30

Department of Consumer Affairs

7. **Funding for Ongoing Cemetery Act Workload Uncertain.** Recommend that the department report at budget hearings (1) on its plan to ensure adequate funding for proposed enforcement activities and (2) under what authority it has extended its loan repayment schedule. G-32
 8. **Department Unable to Demonstrate Significant Improved Performance Under Performance-Based Budgeting.** Recommend that the Legislature, in lieu of adopting new operational flexibilities under performance-based budgeting, renew the existing contract for the budget year. G-34
 9. **Augmentation for Call Center Unnecessary.** Recommend that the Legislature delete \$880,000 and 13.5 positions because the department has not justified the need for this augmentation. (Reduce Item 1111-001-0001 by \$880,000.) G-35
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| 10. Various Augmentations Not Justified. Recommend that the Legislature deny various augmentation requests for an Attorney General rate increase, the Board of Barbering and Cosmetology, and the Athletic Commission because these augmentations are not justified. (Reduce various items by \$370,000, reduce Item 1111-010-0702 by \$668,000 and 16.5 positions, and reduce Item 1140-001-0001 by \$123,000 and two positions.) | G-36 |
| 11. Augmentation Requests for Sunset Boards Are Premature. Recommend that the Legislature not approve \$2.3 million and five positions because it is premature to initiate program modifications for boards that currently are under sunset review by the Legislature. (Reduce various items by \$2.3 million and five positions.) | G-38 |

Department of Fair Employment and Housing

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| 12. Need for Additional Staff Unwarranted. Recommend that the Legislature delete augmentation funding of \$2.5 million and 42 positions because the department has not yet justified its base level of funding, let alone additional resources. (Reduce Item 1700-001-0001 by \$2.5 million.) | G-41 |
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Energy Resources Conservation And Development Commission

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| 13. New Energy Programs Under Electricity Industry Restructuring. Recommend the Legislature not approve the request for \$66.8 million, including budget bill language, for two new programs—Public Interest Research, Development and Demonstration Program and Public Interest Renewable Resource Technology Program—established under recently enacted legislation restructuring the electricity industry until the commission submits to the Legislature an implementation plan for each program. | G-43 |
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Agricultural Labor Relations Board

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| 14. Board Workload Remains Light. Recommend legislation eliminating the board and transferring its duties to the | G-46 |
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- Public Employment Relations Board. This would result in budget-year savings to the General Fund of \$1,067,000 and future annual saving of at least \$2,136,000.
15. **Undisbursed Unpaid Wages Continue to Be Returned to Employers.** Recommend the Legislature enact legislation requiring that unpaid wages collected from an employer found guilty of unfair labor practices be deposited into the General Fund when the worker eligible to receive these wages cannot be located. G-49

Department of Industrial Relations

16. **Prevailing Wage Changes.** Recommend that the Legislature delete \$1,266,000 and 20 personnel-years to determine prevailing wages because DIR has not justified the need for additional personnel in the budget year. (Reduce Item 8350-001-0001 by \$1,266,000.) G-50
17. **Managed Care Unit.** Recommend that the Legislature delete \$395,000 and ten positions for the Managed Care Unit within the Division of Workers' Compensation because there is virtually no workload for these positions and there are insufficient fee revenues to support the program. (Delete Item 8350-001-0032.) G-52

Department of Food and Agriculture

18. **General Fund Monies Proposed for Pest Control Program.** Recommend that the Legislature approve \$1 million in General Fund expenditures and seven positions on a two-year, limited-term basis until the department can demonstrate the benefits of the program and develop an alternative funding source. G-54
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| 19. Salary Increase for University of California (UC) Employees Should Not Require a General Fund Augmentation. Recommend that the Legislature delete a \$509,000 General Fund augmentation for a salary increase granted by UC to veterinary laboratory employees because either UC should provide funding for the pay raises of these UC employees or the department should absorb the costs within current budget resources. (Reduce Item 8570-001-0001 by \$509,000.) | G-55 |
| 20. Industry Should Pay for Agricultural Export Liaison Program. Recommend that the Legislature enact trailer bill legislation authorizing the Department of Food and Agriculture to assess the agricultural industry for the state's cost of the agricultural export liaison and database program. Accordingly, we recommend that the Legislature structure the \$364,000 appropriation in Item 8570-001-0001 as a reimbursement. | G-56 |
| 21. Medfly Program Update. Withhold making recommendations on the department's ongoing sterile Medfly release program pending receipt of the department's report that is due March 1, 1997. | G-57 |

Board of Equalization

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| 22. Legislature Needs More Information to Evaluate Requests. Recommend that the Legislature not approve \$4.7 million and 21 positions for the Board of Equalization (BOE) that are requested, for the most part, on the basis of potential revenue benefits or losses because the Legislature does not have sufficient information to review the validity of the methodology used by BOE to make revenue impact calculations. We further recommend that BOE submit a report to the Legislature evaluating the revenue impact of previous audit programs. | G-58 |
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Franchise Tax Board

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| 23. Augmentation for State Tourism Program Unnecessary. Recommend that the Legislature delete \$1.9 million in reimbursements from the Trade and Commerce Agency and 27 positions because the collection and enforcement of | G-60 |
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businesses' self-assessed fees should not be the responsibility of the state Franchise Tax Board (FTB).	
24. Legislature Needs More Information to Evaluate Requests. Recommend that the Legislature not approve \$14.2 million and 124 positions for the FTB that are requested, on the most part, on the basis of potential revenue benefits or losses because the Legislature does not have sufficient information to review the validity of the methodology used by FTB to make revenue impact calculations. We further recommend that FTB submit a report to the Legislature evaluating the revenue impact of previous audit program augmentations.	G-62
Department of Information Technology	
25. Year 2000 Project. Department has been diligent in its efforts to provide leadership to departments which have to convert computer programs to accommodate pending millennium change.	G-64
26. Departmental Performance. Although it is too soon to determine how successful the department will be in fulfilling statutory mandates, preliminary results are mixed. We recommend continued funding, but that the Legislature closely monitor the department.	G-66
27. Inaccuracy of Estimates for State Projects. Recommend adoption of supplemental report language requiring sensitivity assessment of project estimates.	G-72
28. Apprising Legislature of Major Projects. Recommend adoption of supplemental report language requiring that the Legislature receive notification and documentation for any information technology project costing \$1 million or more.	G-73
Stephen P. Teale Data Center	
29. Premature Request for New Facility. Recommend deletion of budget bill language authorizing Department of General Services to enter into agreement for new data center facility, because request is premature.	G-74

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| 30. Legal Expenses Increasing Significantly. Recommend data center and Department of Justice advise Legislature at the time of budget hearings as to reasons for increases in legal expenses, the use of outside counsel, and steps to reduce data center exposure to litigation. | G-76 |
| 31. Human Resources Information System Continues to Lose Money. Reduce Item 2780-001-0683 by \$410,000, and increase reimbursements by same amount. Recommend shift to reimbursements to ensure that service breaks even. | G-78 |
| 32. Mainframe Computing Upgrades May Be Overstated. Withhold recommendation on \$4.9 million to upgrade capacity to accommodate customer workload pending validation of the anticipated workload. | G-79 |
| 33. Telecommunications Augmentation Appears Overstated. Withhold recommendation on \$2.5 million to increase telecommunications services pending reassessment of workload causing this increase. | G-80 |
| 34. Disaster Recovery Program Augmentation Unclear. Withhold recommendation on \$500,000 augmentation to disaster recovery program pending resolution of discrepancies in budget support documents. | G-80 |
| 35. Technical Issues. Reduce Item 2780-001-0683 by \$520,000. Recommend reductions due to overbudgeting of general expenses and out-of-state travel. | G-81 |

Health and Welfare Agency Data Center

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| 36. Cost Increase to the Statewide Automated Welfare System (SAWS). Withhold recommendation on \$12.6 million for continued development of SAWS, pending further review of documentation concerning the project. | G-82 |
| 37. Continued Delays in Statewide Automated Child Support System (SACSS). Withhold recommendation on \$37.9 million for continued implementation of SACSS, pending review of special progress report detailing changes needed to address system performance problems. | G-84 |

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| 38. Statewide Child Welfare Services Case Management System Expenditures Not Justified. Reduce Item 4130-001-0632 by \$10 million. Recommend deletion of expenditures which are more appropriately assumed by counties or which have not been justified. | G-86 |
| 39. Statewide Fingerprint Imaging System (SFIS) Expenditures Should Await Report and Bid. Recommend \$6 million budgeted for SFIS be deleted from Item 4130-001-0632, and authorization for expenditure of equivalent amount be placed in budget bill provision, pending completion of required report and award of bid for project. | G-87 |

Office of Emergency Services

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| 40. Proposed Budget Is Only Rough Estimate. The proposed budget will have to be adjusted to reflect costs associated with recent statewide floods. | G-90 |
| 41. Failure to Provide Legislature With Expenditure Information. The office has failed to respond to legislative direction for information on payment of disaster recovery claims to local agencies. | G-91 |
| 42. Slow Improvement in Departmental Performance. The ability of the office to effectively carry out its disaster recovery and hazard mitigation responsibilities continues to be hampered by internal shortcomings. | G-91 |
| 43. Disaster Expenditures Should Be Highlighted in Governor's Budget. Recommend that Legislature adopt supplemental report language directing the Department of Finance to schedule budgeted expenditures for local assistance separately in Governor's budget document for each declared disaster. | G-94 |
| 44. Hazard Mitigation. Office is not adequately tracking status of recommendations to mitigate effects of future disasters. | G-95 |
| 45. New Training Program. Withhold recommendation on \$481,000 requested for centralized training facility for urban search and rescue program, pending receipt of additional information. | G-96 |
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| 46. Management of Fire Engines Should Be Moved. Withhold recommendation on \$277,000 requested to upgrade firefighting equipment, pending receipt of report prior to budget hearings, on how program can be merged with California Department of Forestry and Fire Protection. | G-97 |

State Controller

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| 47. Performance Audit Progress Report. The Controller's report on results of implementing recommendations of a performance audit leaves important questions unanswered. | G-98 |
| 48. No Funds for Information Technology Improvements. Recommend that the Controller and the Department of Finance submit a plan to the budget subcommittees, prior to budget hearings, that specifies how and when critical information technology needs cited in the Controller's 1995 performance audit will be met. | G-99 |
| 49. Notification Limitation Not Justified. Recommend deletion of proposed budget bill language which would unduly limit the Controller's ability to process the backlog of notifications intended to locate the owners of unclaimed property held by the state. | G-101 |

Secretary of State

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| 50. Implementing Proposition 208. Recommend that the Secretary of State and the Department of Finance submit a plan to the budget subcommittees prior to budget hearings that specifies how the Secretary will implement Proposition 208. | G-103 |
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California Science Center

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| 51. Funding Increase to Open New Science Center. Withhold recommendation on a \$6.3 million augmentation requested by the California Science Center to open its new science and technology exhibit hall until the center completes a study on transferring its operations to an auxiliary support organization. Withhold recommendation on proposed law change to shift parking revenues from General Fund to | G-106 |
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center. Recommend Legislature consider options of establishing admission fees at the center, and supporting center with Proposition 98 education funds.	
Department of General Services	
52. Departmental Performance. Department appears committed to improving departmental performance overall.	G-111
Statewide Support Services	
53. Marginal Warehouse Operation. Recommend adoption of supplemental report language requiring department to submit a plan to phase out surplus property warehouse operations.	G-112
54. Questions About State Pay Telephone Contracts. Withhold recommendation on \$451,000 and 2.8 personnel-years to manage state pay telephone contracts, pending report prior to budget hearings as to administration's plans for renewing the contracts.	G-113
55. Questionable Use of Sole Source Contracts. Recommend department review policy of authorizing exemptions from competitive acquisition and report to Legislature prior to budget hearings as to how its policy is consistent with Legislative and administration policy.	G-115
56. Concerns About Approach Taken to CALNET and State Telecommunications Networks. Recommend that administration report during budget hearings as to status of efforts to implement new telecommunications plan.	G-117
57. Department Only Partially Responsive to Legislative Direction. Department has not been fully responsive to Legislative direction regarding its annual strategic telecommunications plan.	G-120
58. Inadequate Justification for State Vehicle Fleet Augmentation. Withhold recommendation on \$5.9 million requested to replace vehicles pending receipt of additional information from department.	G-120
59. End of Cash Flow Problems for 911 Program. Recently enacted legislation anticipated to resolve perennial cash	G-121

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flow problem in State Emergency Telephone Number Account.	
60. Additional Additions to Performance Budget Contract Should Be Denied. Recommend Legislature not approve additional exemptions, through budget bill, for exemptions from various statutes.	G-122
<i>Property Management Services</i>	
61. Revise Leasing Requirements. Recommend changes in current law for leasing of state office space that would enhance legislative oversight by requiring notification to the Legislature (1) for all high-cost leases and (2) early in the leasing process.	G-123
62. Surplus Property Assessments. Withhold recommendation on \$100,000 under Item 1760-015-0002(g)(1) for a property development study of a the California Institution for Men, a prison site in Chino, pending completion of a master plan for that site.	G-126
State Personnel Board	
63. Augmentation Unnecessary to Review Civil Service Classifications. We recommend that the Legislature delete \$219,000 from the General Fund for 2.3 limited-term personnel-years to review state civil service classifications because this work is fundamental to the State Personnel Board (SPB) and should be undertaken on a priority basis within the current budget. (Reduce Item 1880-001-0001 by \$219,000.)	G-128
64. The SPB Should Not Relocate Offices. We recommend that the Legislature adopt budget bill language to not allow the SPB's proposed move to the Food and Agriculture Building because the office space in this building should be occupied by state employees currently located in leased space.	G-129
Trade and Commerce Agency	
65. New Foreign Offices. Recommend that the Legislature delete \$939,000 requested for three new foreign offices	G-131

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| because establishing foreign offices should be considered as a policy issue through legislation other than the budget bill. | |
| 66. Tourism Marketing Act. Recommend that the Legislature direct the agency not to contract with the state Franchise Tax Board to collect and enforce business self-assessment fees for the Tourism Marketing Program. | G-133 |

Department of Personnel Administration

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| 67. Review of Personnel and Payroll Systems. Recommend that the Legislature delete the request for \$585,000 from the General Fund for a business process review of the state's personnel and payroll systems because the need for or extent of such a review is unclear at this time and a review of this nature would more appropriately be conducted through the State Controller's Office, rather than the Department of Personnel Administration. (Delete \$585,000 from Item 8380-001-0001.) | G-137 |
| 68. Executive Leadership Training Program. Recommend that the Legislature not approve \$775,000 in reimbursement authority to initiate an executive leadership training program until the Department of Personnel Administration provides specific information on (1) problems with the current practice of using private and public seminars for this training and (2) the benefits of the proposed training (at a cost of \$5,000 per executive) compared to the existing practice. | G-138 |
| 69. Administration of Workers' Compensation Claims. Recommend that the Department of Personnel Administration report to the Legislature on what steps it will take to reduce state costs through the upcoming negotiations with the State Compensation Insurance Fund for a new Master Agreement to administer workers' compensation claims for state departments. | G-139 |
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| 70. Collective Bargaining Agreements. Recommend that the Department of Personnel Administration report to the budget committees during budget hearings on the administration's collective bargaining proposals and the status of negotiations. | G-140 |

Department of Finance

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| 71. Oversight of Performance-Budgeting Pilot Project. Recommend that the department advise the Legislature during budget hearings as to the status of the project and the extension of administrative flexibilities to all state agencies. | G-142 |
| 72. Inappropriate Use of Budget Bill. Recommend that Legislature not approve performance budget contracts through budget bill provisions which should more appropriately be addressed through separate legislation or written agreements. | G-144 |
| 73. Freeze Current Budget Contracts Pending Significant Performance Improvement. Recommend that the Legislature not adopt proposed additional administrative flexibilities until significant improvements in departmental performance can be demonstrated. | G-145 |
| 74. Cost of Converting State Computer Programs for Year 2000. Recommend the Department of Finance (DOF) advise the Legislature as to the estimated conversion cost and how the cost will be budgeted. | G-145 |
| 75. Highlighting Information Technology Expenditures in Governor's Budget. Recommend supplemental report language directing the DOF to identify information technology budgets and major projects in the Governor's budget. | G-146 |

Military Department

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| 76. Maintenance Program Should Be Supported by Sale or Lease of Surplus Armories. Recommend that 24 new positions proposed to upgrade and maintain armories and air bases and a previously funded asset manager be provided | G-148 |
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for a two-year limited term. Recommend budget bill language directing that the General Fund appropriation be automatically reduced by any additional revenues received by the department from the sale or lease of surplus armories.

77. **Homeless Shelter Program to Expire.** A program under which armories are used to shelter homeless persons in cold weather will expire in March 1997. The Legislature should consider extending the program after it reviews a forthcoming evaluation. G-150

Department of Veterans Affairs

78. **Yountville Home General Fund Costs Increasing.** The state General Fund support for operating the Yountville veterans' home has begun to rise. G-152
79. **Bureau of State Audits (BSA) Recommends Many Changes at Yountville.** A recent audit recommends changes in Yountville operations that could eventually reduce its General Fund costs by more than \$7 million. Recommend the immediate adoption of five proposals that could save \$1.6 million. Further recommend that department and BSA report at budget hearing regarding how other BSA proposals could be implemented. G-154
80. **Yountville Augmentation Request Overbudgeted. Reduce Item 8960-011-0001 by \$499,000 and Increase Federal Funds and Reimbursements by \$400,000.** Recommend \$1.4 million augmentation request be reduced to \$1.3 million and modified to eliminate additional pathology positions, to ensure that a telecommunications project is cost-beneficial, and to shift some costs from the General Fund to other funding sources. G-157
81. **Barstow Home Occupation Still Short.** Withhold recommendation on \$17.2 million budgeted for the home pending updated population estimates because the facility has been repeatedly overbudgeted. G-159
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Veterans Memorial Commission

82. **Memorial Project Remains in Doubt.** Recommend enactment of legislation to abolish the Veterans Memorial Commission next year and transfer its remaining assets to an appropriate private or public program that would benefit or memorialize the efforts of California veterans. G-162

Health and Dental Benefits for Annuitants

83. **Budget-Year Costs Are Uncertain.** Withhold recommendation on the \$278.7 million General Fund request for Health and Dental Benefits for Annuitants pending final determination of premium rates for calendar year 1998. G-166

Control Section 3.60

84. **Public Employees' Retirement System Employer Contribution Rates.** Withhold recommendation on employer contribution rates for retirement benefits pending (1) final determination of the actual rates to be applied in the budget year and (2) receipt and review of information regarding the actuarial assumptions underlying the rates. G-168

Local Government Financing

85. **Citizen's Option for Public Safety.** Recommend Legislature reconsider its goals for the COPS program and either transfer the proposed \$100 million to another public safety program—or use the funds to provide general purpose local fiscal relief. G-173

