MAJOR ISSUES

General Government

✔ Legislature Needs Update on Status of Smog Check Program

- Many elements of the Smog Check program have been delayed and other elements have not been implemented. Consequently, it is uncertain whether the program is still on track for meeting the requirements of the State Implementation Plan as agreed to by the state and the federal Environmental Protection Agency.

- We recommend the Legislature not approve the $71 million requested for the Smog Check program until the Department of Consumer Affairs reports on the status of the program (see page F-35 to F-43).

✔ Expiration of Information Technology Oversight Agency Provides Opportunities

- The law that created the Department of Information Technology (DOIT) will expire at the end of the budget year. Although DOIT has not met all of the Legislature's expectations, we believe that it has played a useful role in information technology oversight, policy development, and planning. Thus, we recommend the enactment of legislation to extend the life of the department.

- While considering legislation to extend DOIT, we recommend that the Legislature consider a number of issues that could improve the operations of the department and state information technology generally (see page F-72 to F-75).

✔ Employee Compensation

- Most employee bargaining units have been in negotiations with the state for new memoranda of understanding (MOUs) since 1995. The Legislature has approved MOUs in the current year for four bargaining units, and a fifth unit has an MOU pending before the Legislature.

- The Governor's budget includes (1) $168 million ($64 million General Fund) for the annual cost of any salary increases approved in the current year for employees in the 16 bargaining units without MOUs and (2) $190 million ($100 million General Fund) for any budget-year salary increases that are agreed upon in collective bargaining negotiations with all 21 bargaining units.
- Salary increases will depend on collective bargaining. However, the proposed amount could, as an example, cover a 3 percent increase in the current year for those currently in collective bargaining and 2 percent in the budget year for *all* employees (see page F-124 to F-127).

Citizens' Option for Public Safety Program Should Be Reconsidered

- The Governor's proposal to modify and make permanent the Citizens' Option for Public Safety (COPS) program does not remedy the program's problems and will only exacerbate them.
- We recommend that the Legislature reject the Governor's proposal and instead consider the COPS monies in the larger context of state resources provided to restore the fiscal health of local governments. We suggest that any local government relief funds be used to transform California's system of local government finance into one that reflects modern needs and preferences of communities (see page F-131 to F-134).

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OVERVIEW

General Government

Total funding for general government is proposed to increase in the budget year. The General Fund portion of the budget is proposed to increase substantially, while the special fund portion is proposed to decrease slightly. The increase in support from the General Fund is primarily a result of large increases in (1) tax relief payments to local governments to offset the revenue loss caused by the cut in the vehicle license fee ($523 million) and (2) the annual payment to the State Teachers' Retirement System, largely to pay for the costs of new benefits ($641 million).

The General Government section of the budget contains a variety of programs and departments with a wide range of responsibilities and functions. These programs and departments provide financial assistance to local governments, protect consumers, promote business development, provide services to state agencies, ensure fair employment practices, and collect revenue to fund state operations. The *1999-00 Governor's Budget* proposes $9.4 billion to fund these functions, not including federal funds. The proposed budget-year funding is $797 million more than estimated 1998-99 expenditures.

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.
- Tax collection programs.
- State administrative functions.

- State retirement and employment.

We describe these program areas below and Figure 1 shows the estimated 1998-99 and proposed 1999-00 budget expenditures by program area.

Figure 1

General Government Spending

1998-99 and 1999-00
(In Millions)

Program	1998-99	1999-00	Difference
Shared revenue	$3,459.5	$3,255.4	-$204.1
Tax Relief	1,022.5	1,618.4	595.9
Local government financing	176.9	111.2	-65.7
Regulatory programs	1,299.6	1,280.8	-18.8
Tax collection programs	574.0	568.4	-5.6
State administration programs	965.2	908.3	-56.9
Retirement and employment	1,090.5	1,642.4	551.9
Totals	**$8,588.2**	**$9,384.9**	**$796.7**

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 $3.3 billion for shared revenues (virtually all from special funds), a decrease of $204 million, or 5.9 percent, below the current-year amount. This decrease is related to the recently enacted 25 percent reduction in the vehicle license fee (VLF). This tax cut did not affect the amount of funds received by local governments. It did, however, shift some of the funding for these local allocations from shared revenues to the General Fund.

Tax Relief

The state provides local property tax relief, both as subventions to local governments and as direct payments to eligible taxpayers, through eight different programs. The two largest are the VLF Offset and the Homeowners' Property Tax Relief (homeowners' exemption) programs. The Governor's budget proposes an expenditure of $1.1 billion on the VLF offset in 1999-00, which comprises most of the $1.6 billion budgeted for tax relief.

Local Government Financing

The Governor's budget proposes to subvene $111 million (all General Fund) to cities and counties. Almost all of this amount ($100 million) would go for continuation of the Citizens' Option for Public Safety, a program created in 1996-97 that distributes money on a per capita basis to local governments for criminal justice services.

Regulatory Activities

A total of 21 agencies are responsible for providing regulatory oversight of various consumer and business issues. Most of these departments are funded from special funds that receive revenue from those subject to regulation. Included in this total are the Departments of Consumer Affairs, Industrial Relations, Food and Agriculture, Financial Institutions, and Corporations, as well as the Public Utilities Commission.

The total proposed expenditures for all regulatory activities in the budget year are $1.3 billion. This includes approximately $1 billion from special funds and $246 million from the General Fund. Total expenditures in this category are $19 million, or 1.5 percent, less than the estimated current-year expenditures. The four largest agencies in terms of overall proposed budget expenditures are the Department of Consumer Affairs, $332 million ($761,000 General Fund); the Energy Commission, $214 million (all special funds); the Department of Industrial Relations, $186 million ($144 million General Fund); and the Department of Food and Agriculture, $185 million ($70 million General Fund).

These regulatory agencies protect the consumer and promote business development while regulating various aspects of licensee, business, and employment practices. The groups regulated range from individual licensees to large corporations.

Tax Collection Programs

Expenditures. The Franchise Tax Board and the Board of Equalization 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 $568 million for these tax programs in 1999-00. This is a decrease of $5.7 million, or 1 percent, from estimated current-year expenditures.

Revenues. The Governor's budget estimates combined General Fund collections by both boards will be $57.2 billion in 1999-00. This is an increase of $4 billion above the administration's estimate of current-year revenues. Half of all General Fund revenues ($30.2 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 the 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, the Military Department, and the Department of Veterans Affairs).

The budget proposes a total of $908 million to support these functions in 1999-00. This is a decrease of $57 million, or 5.9 percent, from current-year expenditures.

State Retirement Programs

Retirement-related expenditures account for a significant part of state spending for the budget year. In 1999-00, state expenditures for various costs associated with public employee retirement (excluding University of California costs) will total $2.6 billion, including $2.1 billion from the General Fund. As summarized in Figure 2, the General Fund provides for employer contributions and/or various other payments to four retirement systems. In addition, the state (1) contributes to the payment of premiums for health and dental benefit plans for retired state employees and (2) makes Social Security and Medicare contributions for most state employees.

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, have historically been insufficient to provide for the cost of basic retirement benefits, the protection of retirees' purchasing power, and to cover past unfunded liabilities. These shortfalls have been covered by annual transfers from the General Fund.

Figure 2

General Fund Costs For Retirement Programs[a]

1999-00 (In Millions)

State Retirement Plans	
State Teachers' Retirement	$934
Public Employees' Retirement[b]	408
Judges' Retirement	85
Defined Contribution Plan[c]	24
Legislators' Retirement	1
Subtotal	($1,452)
Other Retirement Benefits	
Health and Dental Benefits for Annuitants	$347
Social Security and Medicare[d]	307
Subtotal	($654)
Total	**$2,106**

a Excludes costs for University of California employees.
b Includes 2 percent "pick up" for Bargaining Unit 8 employees' retirement contribution.
c New program established for Bargaining Unit 6.
d Legislative Analyst's Office estimate based on 1997-98 costs.

The state's General Fund payment to STRS will increase $641 million in the budget year. This is because:

- In 1998, the Legislature enhanced retirement benefits for members of STRS who retire on or after January 1, 1999 and provided General Fund support to pay for these new benefits beginning in 1999-00. (Figure 3 outlines these changes.) The budget-year cost of the enhanced benefits is $517 million.
- In 1998, the Legislature also reamortized the state's obligation to retire the unfunded liability of STRS, resulting in a current-year payment for this purpose of $209 million. As discussed below, STRS should now be fully funded and accordingly the Governor's budget does not include funding for this purpose.
- The state's General Fund payment for purchasing power protection will be $333 million higher in 1999-00. This is basically due to

a one-time $320 million reduction in the current year, resulting from the sale of the Elk Hills Petroleum Reserve.

The legislation enacted in 1998 (Chapter 967, Statutes of 1998 [AB 2804, Committee on Public Employees, Retirement, and Social Security]) provided that the portion of the state's annual payment to STRS that is used to reduce its underfunded status would be eliminated if there were no longer any shortfall. The budget assumes that the actuarial valuation of STRS called for by the Legislature in the *1998-99 Budget Act* and due by April 1, 1999 will determine that there is no longer a need to pay these costs. This results in a General Fund savings of $85.5 million in 1999-00. At its January 1999 meeting, the STRS board took action to authorize this actuarial valuation.

Figure 3

Enhanced Benefits for Members of The State Teachers' Retirement System

☑ **Chapter 966, Statutes of 1998 (AB 1150, Prenter)**

- Increases retirement allowances by incrementally raising the age factor from 2 percent of final compensation per year of service at age 60 to a maximum of 2.4 percent at age 63.

☑ **Chapter 1006, Statutes of 1998 (AB 1102, Knox)**

- Increases the per-year-of-service factor by an additional two-tenths of 1 percent of final compensation (not to exceed 2.4 percent) for members who have 30 or more years of service credits.
- Grants credit for unused sick leave for purposes of calculating retirement benefits.
- Establishes, as a vested right, purchasing power protection of up to 75 percent of the initial monthly retirement benefit.

☑ **Chapter 967, Statutes of 1998 (AB 2804, Committee on Public Employees, Retirement, and Social Security)**

- Establishes a financing mechanism to pay for the benefits included in AB 1102 and AB 1150.

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 $408 million for PERS in 1999-00. Until 1997-98, General Fund contributions were made two fiscal years in arrears, pursuant to the provisions of Chapter 71, Statutes of 1993 (SB 240, Committee on Budget and Fiscal Review). As a result of a lawsuit filed by PERS, the Superior Court in Sacramento County ordered the state to pay all deferred payments plus interest and to resume sending state funds to PERS on a current, rather than a deferred, basis. The state paid $1.2 billion in deferred contributions in 1997-98 and related interest of $333 million in the current year.

Health and Dental Premiums. The budget also includes $347 million from the General Fund to pay the state share of health and dental insurance premiums for retired state employees and their qualifying beneficiaries. This is $29.6 million more than estimated current-year expenditures, reflecting 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

There are over 150,000 rank-and-file state employees (other than higher education) covered under state collective bargaining law. The pay, benefits, and working conditions for these employees are typically spelled out in memoranda of understanding (MOUs). The MOUs for most of the state's 21 bargaining units expired on June 30, 1995. In the current year, the Legislature has approved MOUs for four bargaining units covering 1998-99. In addition, the California Highway Patrol has reached an agreement for the current year, but it has not yet been approved by the Legislature. The remaining groups are still in negotiations.

The Governor's budget includes $358 million ($164 million General Fund and $194 million from other funds) to provide increased compensation to state employees (other than employees in higher education). The $358 million consists of (1) $168 million ($64 million General Fund) for the annual cost of any increases in employee compensation that are approved in the current year for employees currently in collective bargaining negotiations and (2) $190 million ($100 million General Fund) for employee compensation changes that may be agreed to through collective bargaining and become effective in the budget year. Actual salary increases provided to employees by these funds are dependent on the terms of negotiated agreements. As an example, however, the $168 million amount could cover the annual cost of an average pay increase of 3 percent for those currently in collective bargaining. The $190 million that would be available for changes in the budget year could provide an additional salary increase of 2 percent for *all* employees.

CROSSCUTTING ISSUES

General Government

EVALUATING INFORMATION TECHNOLOGY PROJECTS

The state has become increasingly reliant on information technology. Each year, the Legislature is asked to approve information technology projects and provide large sums of money to support projects. In this piece, we provide the Legislature with a "checklist" to use when reviewing these proposals.

In recent years, state government has come to rely more and more on information technology (IT) to accomplish its objectives. According to the Department of Information Technology (DOIT), the state spends over $2 billion annually for IT. State IT is used in almost every facet of government—from processing of licenses, to keeping records, to determining who is eligible for services and benefits, to providing communication among state workers and the public.

As a consequence of this reliance, the Legislature is asked each year to approve requests from the administration to develop new IT projects or modify existing projects. Almost all include requests for an appropriation of funds. In addition, the Legislature will frequently be called upon to provide additional funding in the years following initial approval since most projects stretch over multiple years.

Even though both houses of the Legislature have established committees that play a role in the oversight of state IT, review and approval of requests is often dispersed throughout the Legislature. Project and funding requests come to each of the individual budget subcommittees for inclusion in the annual budget act, and sometimes to policy and appropriations committees for those projects that seek approval and funding outside the budget process.

In this piece, we provide a short guide to the Legislature that it can use when reviewing IT requests, both for initial project approval and funding and for subsequent funding at later stages of the project. We outline criteria and questions that the Legislature can use in the review process. These questions are not meant to be all-inclusive but rather examples of the types of questions that might be asked.

What About the Role of the Executive Branch? The IT project requests that come to the Legislature have already been approved by the management of the department bringing the request. Most projects will also have been reviewed and approved by DOIT, the state agency that oversees IT (most, but not all, entities of state government are subject to DOIT's oversight). In addition, the Department of Finance (DOF) and its Technology Investment Review Unit (TIRU) will have reviewed and approved the project from a financial standpoint. The Department of General Services (DGS), which is responsible for state procurement (including IT procurement) and telecommunications, may also play an oversight role.

Although many of the issues we outline will have already been considered by these oversight agencies, our experience indicates that sometimes the oversight agencies have a different perspective than the Legislature about the relative importance of a particular issue. In addition, experience has shown that projects are sometimes approved by the executive branch agencies despite apparent problems and warning signs.

The Legislature should not "micromanage" IT, but it has the general responsibility of overseeing the operations of the executive branch, including its IT projects. There is no guarantee that additional oversight will prevent failure of projects. However, given the number of troubled projects that the state has encountered in recent years, we believe that oversight by the Legislatures can only help and is more important than ever.

What Questions Should The Legislature Ask?

Figure 1 (see page 16) outlines the most important questions that we believe the Legislature should ask when reviewing an IT project proposal or obtaining a status report on a project that is being implemented. The questions are based on our assessment of what it takes to implement a successful IT project and are borrowed heavily from "best practices" used in the private sector to procure and deploy IT. These best practices are strategies derived from experienced industry experts who have, through trial and error, discovered methods for design, development, and operation of computer systems which increase the chances of success and decrease risk (for more information on best practices in IT, see our recent report *State Should Employ "Best Practices" On Information Technology Projects*) We discuss several of the questions in more detail below.

Clearly Identified "Business" Problem. An IT project request must clearly state the problem that needs to be solved, such as tracking an inmate's time in state prison in order to determine his release date. Resolution of the particular problem should be the driving force for an information technology project. If it is not, the department may be automating for automation's sake.

Additionally, the project plan should demonstrate how the proposed project fits in and is consistent with the department's strategic information technology plan, which establishes the direction for IT within the department. Finally, the state has too often made its automation decisions (particularly in social services programs) based on attempts to maximize the receipt of federal funds or reduce the chances of incurring financial penalties from the federal government. We believe that IT decisions should be based on the merits of the project and the clearly defined problems they will solve, not simply as a way of maximizing receipt of federal funds.

Measurable Project Goals. Once the overall business goal is articulated, the department must be able to quantify the specific goals it has for the project. These could include reducing administrative costs, enabling personnel to be more productive, and increasing administrative efficiencies.

Development of Project Management Methodology. Every project should include a project management methodology, which is an agreed upon set of processes which guide the department in managing the project. The methodology should include components such as:

- An evaluation of risk and development of a risk mitigation plan.
- Establishment of points at which decisions must be made to continue, modify, or cancel the project.
- Creation of a staged implementation approach to reduce risk.
- A formal dispute resolution process for escalation of unresolved problems with contractors.

- A process to track resources including money and personnel being expended.
- A process to incorporate programmatic staff into the decision-making process.
- A formalized process for issuing change orders for the project.
- Minimum standards of expertise for project staff.
- A cost accounting system which enables management of resources such as personnel and money.

Figure 1

What Should the Legislature Ask When Reviewing Information Technology Proposals?

☑ **Identification of the "Business"Problem**

- Is the problem clearly stated?
- Is the project consistent with the department's strategic information technology plan?

☑ **Measurable Project Goals**

- Are measurable goals for the project identified?

☑ **Project Management Methodology**

- Does the plan indicate the methodology it will employ?
- Have steps been identified to reduce risk?
- Have decision points been set to modify or cancel the project?
- Does the department have managers in place with proper expertise to implement the project?

☑ **Cost/Benefit Analysis**

- Does the cost/benefit analysis justify the project?
- Does the plan include total project costs, including long-term maintenance?
- Are other factors that could affect the bottom line of the analysis identified?

☑ **Departmental Workload**

- Does the department have other high priority projects which will detract resources from this project?

Continued

✔ **Departmental Track Record**

- Does the department have a track record of success for projects of equivalent size?

✔ **Project Priorities**

- Does the plan prioritize budget, schedule, and functionality?
- Are the department's priorities the same as the Legislature's for the project?

✔ **Oversight**

- If a medium- to high-risk project, has the department hired an independent quality control vendor?
- Is there sufficient oversight of the project by other state agencies, such as the Department of Information Technology?

✔ **Procurement**

- Does the plan require the vendor to propose the technical solution during procurement?
- Will the procurement decision be based on "best value" and not simply lowest cost bid?
- If the project is large, will the department require the vendor to provide the state with a letter of credit?

✔ **Executive Level Sponsor**

- Is there an executive level manager sponsoring the project within the department?

Cost/Benefit Analysis. The funding request should include a cost/benefit analysis that provides an understanding of how much the return on investment will be if the project is deployed. The funding request also should identify when these costs and benefits will be incurred. Be aware that the costs are often understated, but real, while the benefits may be less tangible and do not materialize until years to come. The cost/benefit analysis should include an assessment of known factors that may have a positive or negative effect on the bottom line of this analysis.

Evaluation of Departmental Workload. In addition to IT staff, the department will need to dedicate staff who are knowledgeable about the affected program to the project. If these program staff have other primary responsibilities, it may mean that the project will experience delays.

Evaluation of Department's Track Record. In addition to evaluating the department's resources, the Legislature needs to consider the department's track record in deploying projects of similar complexity and size. A record of failure in previous projects should give the Legislature pause in approving a project, unless the department has evaluated reasons for failure and taken specific steps to correct the actions that led to failure. A track record of success is a relatively good indicator, but by no means a guarantee of future success. The absence of a track record should necessitate a careful review of new proposals.

Identification of Project Priorities. Every IT project has three components which often become competing interests during project deployment: the budget, the schedule, and what the system will do (also known as the "functionality" of the project). The department must clearly rank these three components. Such a ranking allows a project manager when faced with a problem in the project to know which of the three components is the highest priority, which is secondary, and which can be the most flexible.

Ensuring Adequate Project Oversight. Medium- and high-risk projects often benefit from additional support in the form of an independent quality control vendor to help mitigate risk. These vendors, known as quality assurance or independent verification and validation vendors, work for the department by assessing the quality of the work of the prime vendor. Projects which should employ an independent quality control vendor include those that are large, critical to the overall mission of the department, or are being deployed in a department with little experience in deploying a project successfully.

In addition, it is important that the Legislature feel confident that the state oversight agencies, such as DOIT, will provide adequate review and attention to the project. For projects that the Legislature is particularly concerned about, it would be advantageous to request representatives from DOIT to appear at legislative hearings to present their perspectives on the project and to provide an outside assessment of progress.

Procurement Approaches. During the procurement process, the department should not prescribe the technical solution, but request vendors to provide their best thinking. In other words, the department should state what and why it wants to deploy a project and let the vendor community propose how it is to be accomplished. The advantage of such an approach is that it places the burden of success on the vendor which contractually agreed that its solution could resolve the business problem. When the state proposes the solution, the vendor may be able to deliver the solution, but if it does not work, it becomes the state's responsibility to make it work.

In addition, when evaluating bids for projects, we think that the state is better served by evaluating bids based on "best value" rather than simply using the lowest cost bid. "Best value" procurements enable a department to evaluate a bid not just on costs but also on other important considerations, such as the vendor's technological solution, experience in a particular problem area, financial strength of the company, and experience of the vendor's staff.

Finally, for larger projects, we believe that a contract should require the vendor to provide the state with a letter of credit in order to best protect the state's financial interests. A letter of credit may add cost to the project since it will require the vendor to make additional capital available. However, on larger projects, the state's risk is larger and a letter of credit increases its ability to recover potential loses.

Executive Level Sponsor. An executive level manager must support the project and be its advocate within the department and before the Legislature. Executive level support of a project ensures that the project receives the resources and priority within the department that the project will require. Additionally, the executive level sponsor is ultimately responsible for the project and should be held accountable for its progress and outcome.

Conclusion

There is no single reason why IT projects fail. However, we believe that if the state employs the best practices from industry, asks the right questions and acts on those answers, and ensures that the documents are consistent with the answers provided, the chances of success will be significantly increased. For larger, more complex projects, in particular, it will be important for the Legislature to continue to exercise its oversight responsibilities after approving the project by requiring regular updates on the status of the project during fiscal and policy committee hearings.

EVALUATING THE HOUSING TASK FORCE'S AGENDA

INTRODUCTION

As part of his budget proposal, the Governor announced the creation of a Housing Task Force to develop a plan for increasing housing affordability in California. Among other issues, the Governor specifically charged the task force with making recommendations regarding: (1) the potential loss of federal affordable housing contracts, (2) the use of redevelopment housing funds, and (3) the relationship between housing and land use. Among the task force's members are the Lieutenant Governor; Treasurer; and Secretary of the Business, Transportation, and Housing Agency. To finance the operation of the task force, the Governor has set aside $2.5 million from the General Fund in the Department of Housing and Community Development's (HCD) budget.

Federal housing contracts and local redevelopment agencies provide two of the largest sources of funding for affordable housing in California. In addition, land use decisions made by local governments play a major role in determining the extent to which affordable housing is provided. This piece, therefore, provides background and key considerations in these areas to assist the Legislature in evaluating forthcoming proposals from the task force.

FEDERAL HOUSING CONTRACTS

Housing analysts typically recommend that households spend no more than 30 percent of their income on housing. Spending more than this amount can leave households without sufficient resources for their other day-to-day financial needs. However, without some form of assistance, many low-income households are unable to find suitable housing within this spending standard.

During the 1970s, the federal Department of Housing and Urban Development (HUD) developed a mechanism for ensuring that eligible households could meet this spending standard. The HUD signed long-term "Section 8" contracts with apartment owners to set aside a number of units for HUD-sponsored tenants. In exchange for agreeing to provide affordable units for a period of at least two decades, private landlords and developers received the guarantee of tenants. A household living in one of these units pays 30 percent of their income, and HUD contributes the necessary amount to increase the total payment to the agreed-upon rent.

There are more than 110,000 housing units covered by Section 8 contracts across the state. These contracts represent about 3 percent of the state's entire multifamily stock of four million units.

Congress has recently changed its approach to the expiration of these contracts in order to (1) subsidize individual tenants rather than specific units and (2) reduce annual housing expenditures. As contracts expire today, private landlords are generally under no obligation to renew their relationship with HUD. Based on their project's circumstances and the local housing market, owners can choose to convert their units to unsubsidized rents. Since 1996, an estimated 9,000 units have elected to convert to unsubsidized units. Up to 40,000 additional units (concentrated in the state's urban centers) could convert to unsubsidized rents by the end of federal fiscal year 2000.

Some Key Considerations Regarding the Loss of Federal Contracts

Uncertainty Surrounds Conversions. Since the decision to convert to private rents through opt-out or prepayment rests with the private housing owner, it is impossible to predict precisely how many units will convert in the coming years. Moreover, HUD now renews contracts on a year-to-year basis only, therefore, any unit that renews its contract in one year will once again be eligible for conversion in the following year.

For tenants living in units converting to the private market, HUD typically provides a voucher entitling them to an equivalent level of rent or to a rent deemed suitable for the area. However, there is no certainty as to how long these vouchers will be provided. The provision of both vouchers and contract renewals is subject to annual congressional appropriations.

Potential Delayed Impact. While many units will convert to unsubsidized rents in the next few years, current HUD tenants likely will continue to be subsidized in some capacity in the short term. The greatest impact for California residents would occur in the long term if the vouchers are also phased out, the lost affordable units were never replaced, and no alternative approach to providing affordable housing was developed. The replacement of affordable units is greatly confined by (1) limited subsidy funds to make projects viable, (2) community resistance to new affordable projects, and (3) the limited financial incentive for local governments to encourage new affordable housing.

Transition to Vouchers Has Tradeoffs. The HUD has promoted the concept that its tenants are better served by the capacity to choose their housing location through the provision of housing vouchers. The vouchers allow tenants to select their housing from among any units within a certain price range, whereas Section 8 contracts tie tenants to particular units. While this can allow tenants to improve their neighborhood, school options, or proximity to work, many voucher holders have reported problems related to finding housing with vouchers:

- ***Complexes Not Accepting Vouchers.*** Many apartment complexes will explicitly or more subtly not accept Section 8 voucher tenants. This preference for private renters occurs for a combination of reasons, including the desire to avoid administrative interaction with HUD and the perception of some landlords that voucher holders are not dependable tenants.

- ***Insufficient Voucher Amounts.*** The amount of the voucher is based on HUD's calculated fair market rent (FMR), which is meant to represent an average rent amount for each locality. However, the method in which the FMR is calculated—which tends to lower the voucher amount—limits renters' options.

- ***Moving Problems.*** Many Section 8 recipients do not have the funds to cover the typical expenses associated with moving—renting a moving truck, security deposits, and other costs. Tenants that have needed to relocate have also complained of the lack of information that they received regarding procedures for receiving vouchers, available units in the area, and time schedules.

Subset of Total Need. The households receiving Section 8 assistance—both through site-based assistance and vouchers—are generally some of California's lowest income households. It should be recognized, however, that these households currently receiving federal assistance are not the only households with housing needs. For every low-income household that has received HUD assistance, there are many others in similar financial situations that have received no such aid due to waiting lists and limited funding. Providing any assistance to currently subsidized households merely maintains the status quo—a status quo based partially on the "luck of the draw" whether assistance was originally obtained.

Legislative Options. The state has already taken a number of actions in response to the changes in federal housing policy. Chapter 341, Statutes of 1998 (AB 1701, Alquist), adds additional tenant notice requirements (on top of those required by HUD) when a project owner is opting out of or choosing not to renew a Section 8 contract. In addition, the California Housing Finance Agency has included within its business plan its intention to fund a Preservation Financing Program with a combination of taxable and tax-exempt bond financing totaling more than $100 million annually through 2002-03. The funds will be used in a variety of ways to provide financing for projects to maintain or create new affordability requirements.

Potential options for the Legislature to further address changes in federal housing policy include:

- ***Acquisition Funds.*** The state, working through local governments and nonprofit organizations, could provide funds to establish new affordability agreements on projects. However, this approach can be extremely costly. For instance, $15 million vetoed from the 1998-99 budget for this purpose would have preserved the affordability of only 1,000 units.

- ***Improved Transition to Vouchers.*** Through a combination of technical assistance and grants, the state could alleviate some of the existing problems with the HUD voucher system. Options could include encouraging more complexes to accept vouchers, increasing voucher payments, or providing improved information to tenants.

REDEVELOPMENT HOUSING

Redevelopment is a process used by California cities and counties to correct "blighted" conditions in their urban areas. When a community establishes a redevelopment project area, the amount of property taxes flowing to taxing agencies serving the area (city, county, special districts, and school districts) is generally frozen. These taxing agencies continue to receive the same annual dollar amount of property taxes they had received up to that point. Most of the *growth* in property taxes in the project area, however, is allocated to the redevelopment agency as "tax-increment" revenue.

Since 1976, redevelopment agencies have been required to set aside and dedicate 20 percent of their annual tax-increment revenues for the purpose of developing, rehabilitating, or preserving affordable housing. The funds are deposited into each project area's Low and Moderate Income Housing Fund, and their use is restricted to providing housing for households within specified income ranges.

In 1996-97, redevelopment agencies deposited more than $506 million into their housing funds. In the same year, redevelopment agencies spent $479 million on housing and contributed to the development of more than 5,000 affordable housing units. In addition, agencies rehabilitated or acquired affordability restrictions for an additional 4,500 units. Anecdotal evidence overtime, however, has suggested that many redevelopment agencies do not comply with the spirit or letter of the Community Redevelopment Law.

Some Key Considerations Regarding Redevelopment Housing

Lack of State Oversight. California does not have a formal system for state review of redevelopment agency actions, including the development of affordable housing. Most enforcement of laws and penalties is left to the redevelopment agencies themselves and their governing bodies. The lack of a direct state regulatory agency means that other interested parties often have no other recourse besides lawsuits in order to prevent questionable or illegal redevelopment actions. In addition, those reports that are required to be filed with the state on an annual basis have been troubled by inconsistencies, miscalculations, and a lack of timeliness. Consequently, it is unknown whether there is only a small subset of agencies circumventing the intent of state laws or whether there is a more overarching problem with the process as a whole.

Unspent Housing Funds. The Legislature on a number of occasions has sought to better ensure that the agencies timely spend their required housing amounts. Even after spending $479 million during 1996-97 on housing projects, redevelopment agencies had about half a billion dollars in unencumbered funds that were generally available for spending on affordable housing projects as of June 30, 1997. Redevelopment agencies have a number of years to spend these unencumbered funds. If an agency fails to spend its "excess surplus" within the designated time period, then it is subject to self-administered spending limitations and penalties. In its recent annual reports on redevelopment housing, HCD has reported excess surplus funds totaling tens of millions of dollars each year. However, a recent report by the State Auditor revealed that many redevelopment agency surpluses were overstated, due to both inconsistencies in interpretation of the law and calculation errors. Thus, it remains unclear to what extent agencies not spending their surpluses continues to be a statewide problem.

Efficiency of Expenditures. The "use-it-or-lose-it" approach to the redevelopment housing law aims to ensure that funds are spent in a *timely* manner. Yet, few procedures exist to ensure the funds are spent in a *wise* manner. There has been the perception that the agencies spend a disproportionate or excessive amount of their low and moderate income housing funds on administrative costs. In 1996-97, redevelopment agencies spent almost $60 million, or 12 percent of their housing expenditures, on planning and administrative costs. However, this 12 percent rate does not tell the entire story relating to administrative costs.

- ***Individual Project Administration.*** The 12 percent administration rate reflects the overall costs for agency administration. However, many administrative costs incurred by a nonprofit housing developer working on a specific project, for instance, are shown as project expenses—rather than as general administrative costs.

- ***Wide Variation Among Agencies.*** While administrative costs overall average 12 percent, many individual agencies spend a much greater percentage of housing funds on administration. For instance in 1996-97, 20 agencies spent 100 percent of their housing expenditures on administration, and another 34 agencies spent more than 50 percent. While some long-term projects may require extensive planning in their early years, several agencies have spent 100 percent of their housing expenditures on planning and administration for at least three consecutive years.

Legislative Options. Among the possible solutions to these ongoing redevelopment housing problems are:

- ***Formal State Oversight.*** The Attorney General could be provided with the responsibility to formally review redevelopment plans and actions in order to increase compliance with redevelopment laws.

- ***Additional Restrictions on Spending.*** The Legislature could develop spending requirements for agencies that focus more on the outcome of dollars spent (affordable units provided) than on simply spending the dollars by a deadline.

LAND USE AND HOUSING

Under California's system of local finance, cities and counties face various fiscal incentives when deciding how to develop the land within their boundaries. Most communities, for example, receive the highest local tax revenues—and face the least demand for public services—from retail developments. These retail developments provide a source of local sales tax revenues, as well as other traditional revenues such as the property tax. Industrial, office, and agricultural land uses, on the other hand, generally yield much lower tax revenues (since they do not provide sales tax revenues). Finally, housing developments frequently do not yield sufficient local tax revenues to offset a community's increased costs to provide services to its new residents. Moreover, *affordable* housing often creates a greater demand for services in a community while providing the least amount of local tax revenues.

In addition, many California communities have passed measures in recent years that aim to limit or control growth in their areas. While these measures may be able to protect particularly sensitive environmental areas or an individual community's character, they also often can have a significant impact on an entire region's housing supply. Specifically, growth control measures tend to: (1) increase the cost of housing within that community and (2) shift housing development to neighboring communities without such controls. Both of these results create additional pressures on a region's ability to supply affordable housing.

Some Key Considerations Regarding Land Use and Housing

Fiscal Incentives Do Not Promote Affordable Housing. Many cities and counties have oriented their land use planning and approval process disproportionately towards the development of retail establishments, a process referred to as the "fiscalization of land use." As long as the fiscal incentives for land use match local governments' and the state's priorities, linking fiscal incentives and land use decisions helps to ensure beneficial development. However, local jurisdictions do not have the fiscal incentives to develop additional affordable housing.

Land Use Issues Need to Be Placed in Broader Context. These housing/land use concerns are really a part of broader issues related to economic development policy and the state-local fiscal relationship. While the housing task force can make valuable contributions in this area, effective solutions to land use problems must come from a broader spectrum of interested parties. In fact, the Governor has directed his Office of Planning and Research to begin a discussion with local governments regarding the evolving state-local relationship. This would appear a more appropriate venue for developing plans addressing these land use issues.

SOME FINAL CONSIDERATIONS

Where Is State Intervention Most Effective? Local governments play the leading role in determining the cost and availability of housing in their communities—through the adoption of local zoning, growth management, building fees, and other regulatory policies. Therefore, in preparing its plan and recommendations, we would urge the task force to focus its efforts on areas in which the state can achieve its highest effectiveness through the encouragement of local governments to develop additional affordable housing.

Moreover, the issues discussed in this piece are not the only affordable housing issues facing California. Broader structural issues, such as the housing element process, the role of regional governments, and local zoning and permitting practices, also require attention by the task force. Additionally, the Legislature and the task force may wish to evaluate the role of tax policy (that is tax credits, deductions, and other special provisions) in addressing the state's housing goals.

We would recommend that the task force strategically look for the "highest and best use" of the limited state General Fund dollars dedicated to housing. The task force ought to prioritize state spending options by greatest demonstrated need and most effective use of state intervention. At its completion, the task force could then recommend to the Legislature a spending plan that ensures the best results. In conjunction with this concept, we have recommended that funds earmarked by the Governor for various new housing spending instead be held in reserve. (We have recommended that $10 million be set aside—$8 million in proposed funds for specific housing programs and $2 million of the $2.5 million reserved for the task force. Please see page F-98 for more information.) These funds could be allocated by legislation after taking into account the task force's recommendations. This will ensure that the state's new General Fund spending on housing programs will be consistent with the state's highest housing priorities.

Targeting Recipients. As part of its effort to encourage the development of affordable housing, both the task force and the Legislature should recognize that "affordable housing" encompasses a wide band of households. There are many households with extremely low incomes that pay large percentages of their incomes even to live in substandard housing. There are other more moderate income households who, without some government assistance, likely would not be able to afford the purchase of a home. Additionally, there are a variety of groups with special housing needs, such as farmworkers, the homeless, and individuals moving from welfare-to-work. Therefore, based upon which potential recipients are deemed the *highest* housing priority, different approaches are necessary.

Reducing Administrative Costs. A number of the state's housing programs have a history of high administrative and monitoring costs. In considering options for affordable housing, the task force and the Legislature should take steps to avoid a similar fate for any new housing spending. Two of the causes of these high costs have been:

- ***Specialized Programs.*** By spreading minimal housing spending across a wide variety of specialized programs, each program has received a relatively small amount of local assistance funds. This prevents a program from achieving the economies of scale that comes from managing a larger project portfolio. At the same time, each program has been forced to develop its own specialized staff, managers, regulations, and loan application and review processes.
- ***Long-Term Monitoring Requirements.*** Many of the state's housing programs use long-term affordability requirements to mandate that financed projects supply low-income housing over time. In order to ensure compliance with these regulatory agreements and to protect the state's investment, state staff must monitor these projects for the term of the agreements, often up to 50 years. These monitoring activities result in significant state costs for many decades. As an alternative, the task force should look to providing grants or other short-term assistance whenever feasible. For many projects, federal or local monitoring would provide long-term assurances of the project's affordability.

DEPARTMENTAL ISSUES

General Government

DEPARTMENT OF INSURANCE (0845)

Insurance is the only interstate business that is regulated entirely by the states. In California, the Department of Insurance (DOI) is responsible for regulating insurance companies, brokers, and agents in order to protect businesses and consumers who purchase insurance. Currently, there are about 1,600 insurers and 299,000 brokers and agents operating in the state.

The budget proposes total expenditures of $129.9 million for DOI in 1999-00. This is a net $0.6 million, about 0.5 percent, more than estimated current-year expenditures. The changes proposed for the budget year include:

- Consumer Protection—A net reduction of $2.3 million, mainly due to a one-time expenditure of $4 million for the Holocaust Claims Program, as well as augmentations totaling $1.3 million for market conduct examinations and underwriting activities.
- Earthquake Grants and Loans—A $2.3 million increase in local assistance to provide grants and loans to retrofit high-risk residential dwellings owned or occupied by low- or moderate-income households to minimize the risk of future earthquake damage.
- Regulation of Insurance Companies and Insurance Producers—A $0.6 million increase for regulatory activities.

Required Plan Has Not Been Sent to the Legislature

We withhold recommendation on the request for a $1 million General Fund loan to the Insurance Fund to review, investigate, and resolve insurance claims relating to the Holocaust, pending receipt and review of the reimbursement plan as required by the legislation that established this program.

Chapter 963, Statutes of 1998 (SB 1530, Hayden), required DOI to implement a program to review, investigate, and resolve unpaid insurance claims for losses resulting from the activities of the Nazi-controlled German government and its allies for insurance policies written before and during World War II by insurers that currently have California affiliates. If an insurer or its affiliate has not paid a valid claim from Holocaust survivors, DOI must suspend the insurer's certificate of authority, which licenses the company to operate in California, until the insurer or the affiliate pays the claim.

Chapter 963 appropriated $4 million to DOI for expenditure during 1998-99 for this program. The legislation stipulates that funding for subsequent years is subject to the budget act and based on a plan submitted by the Commissioner to the Legislature outlining the plan for reimbursement of expenses of the department by affected insurers. The statute also requires DOI to submit to the insurance and budget committees of the Legislature a biannual report on its (1) progress implementing the program, (2) results in identifying and resolving insurance claims, and (3) current and anticipated program expenditures.

Reimbursement Plan Required by Chapter 963 Not Available. As noted above, Chapter 963 requires DOI to submit its plan for reimbursement of program expenditures to the Legislature as a basis for receiving additional funds after 1998-99. When this *Analysis* was written, this plan had not been sent to the Legislature. In addition, DOI has not spent most of the current-year $4 million appropriation. The DOI staff have advised us that the department is nearing completion of a comprehensive plan for the Holocaust Claims Program. This document will include (1) a plan for program implementation, (2) the plan for reimbursement of expenditures required by Chapter 963, and (3) total proposed funding for the program. According to DOI staff, the comprehensive plan should be available at the time of budget hearings.

Consequently, we withhold recommendation on the request for a $1 million loan from the General Fund to the Insurance Fund pending receipt and review of the reimbursement plan required by Chapter 963.

CALIFORNIA STATE LOTTERY COMMISSION (0850)

The California State Lottery (lottery) was established by the Lottery Act, an initiative statutory and constitutional amendment approved by the voters in 1984. Revenues from lottery sales are deposited in the State Lottery Fund and are continuously appropriated to the California State Lottery Commission. The commission's budget is displayed in the Governor's budget for informational purposes only and is not included in the budget bill.

The lottery act provides that sales revenue is to be distributed annually as follows: 50 percent returned to the public in the form of winnings, *at least* 34 percent for public education, and *no more than* 16 percent for administrative costs. Figure 1 shows the distribution of lottery sales revenue since 1994-95.

Figure 1

Distribution of State Lottery Sales Revenue

1994-95 Through 1999-00
(Dollars in Millions)

	1994-95	1995-96	1996-97	1997-98	Estimate 1998-99	Proposed 1999-00
Annual Sales	$2,166	$2,292	$2,063	$2,294	$2,600	$2,700
Distribution						
Prizes	$1,075	$1,128	$1,031	$1,182	$1,352	$1,418
Education[a]	755	812	712	786	884	918
Administration	336	353	321	327	364	365
Percentage						
Prizes	50%	49%	50%	52%	52%	53%
Education	35	35	35	34	34	34
Administration	16	15	16	14	14	14

[a] This total does not include interest income, unclaimed prizes, or other miscellaneous income distributed to education because these amounts are in addition to the minimum 34 percent allocation mandated by law.

Bridge Project

We recommend that the commission provide the Legislature with information demonstrating that the Bridge Project and associated recent changes in administrative expenses and revenue distribution have furthered the purpose of the Lottery Act by providing increased revenue to education.

In 1997, the lottery implemented the Bridge Project, a three-year strategic management plan to streamline lottery operations, decrease administrative expenses and staff, and increase sales. The budget year will be the third year of the project. The Bridge Project represents a fairly significant administrative restructuring of the lottery. The project's major initiatives have been to:

- Hold administrative expenses at no more than 13.5 percent of sales. It is our understanding that the lottery intends administrative expenses to remain at the 13.5 percent level, with further reductions if possible.
- Allocate all the difference between the statutory 16 percent maximum for administration and actual costs to prizes.
- Reduce staffing levels. The commission cut 219 permanent positions (out of 853) in 1997-98.
- Increase retailer compensation. Retailer commissions are, by law, set at a minimum 5 percent of sales. Under the Bridge Project, commissions will be set at about 6.9 percent of sales in 1999-00 (this compares to a level of about 6.5 percent in 1994-95). Based on estimated sales revenue, this rate increase represents $25 million more in commissions.

Legislative Review. As mentioned above, the Bridge Project is a significant restructuring of the lottery that for several reasons warrants legislative review.

First, the project institutes a change in the revenue distribution—shifting reductions in amounts allocated to administration to prizes rather than education. In the past, and consistent with the Lottery Act, amounts below the maximum 16 percent have been distributed to education at the end of the fiscal year. In 1997-98, however, increasing prize payouts from 50 percent to 51.5 percent resulted in about $35 million of these savings going to prizes, not education. In the budget year the distribution to prizes would be 52.5 percent, resulting in $67.5 million going to prizes rather than education. The lottery believes that offering larger prizes will increase sales and thus result in increased revenue to education. Now that the lottery is in the third year of the Bridge Project, it should have sufficient data to present to the Legislature to substantiate this conclusion. Essentially the lottery needs to be able to substantiate that the increase in sales—related to the additional prize payout—is sufficient to offset the amount education otherwise would have received (for example, the $67.5 million in the budget year).

Second, the Bridge Project increases commissions to retailers. According to the Lottery Act retailer commissions are to be set at a minimum 5 percent of sales. However, for several years the lottery has been steadily increasing this percentage and in the budget year commissions will reach almost 7 percent. This additional 2 percent represents $54 million in the budget year. Similar to the revenue distribution shift mentioned above, the lottery believes increasing retailer commissions will ultimately result in increased sales by providing a larger financial incentive to retailers to promote the games. Since the Lottery has been increasing retailer commissions since 1988-89, we recommend the lottery provide information to the Legislature to demonstrate the beneficial effect to sales.

Legislative Oversight of The Commission's Administration Budget

We recommend that the Legislature include the commission's administration budget in the annual budget bill as an informational item identifying the planned budget-year expenditures, similar to the informational item currently included in the budget bill for the Public Employees' Retirement System.

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 authority to establish its own procurement policies.

In order to give the Legislature a degree of oversight on the state lottery in the budget year, we recommend that the Legislature hold hearings on the commission's proposed 1999-00 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. The informational item also should be included in subsequent budget bills. With this action, the Legislature will have some degree of oversight of the lottery. Holding hearings on the lottery's proposed administrative expenditures will enable the Legislature to review initiatives such as the Bridge Project and determine if the organizational restructuring and associated changes in administrative costs and revenue distribution are indeed furthering the purpose of the Lottery Act—to generate revenues for education.

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 28 semiautonomous regulatory boards and nine bureaus and programs that regulate various professions. The nine bureaus and programs are statutorily under the direct control of the department. The 28 regulatory boards are administered by appointed consumer and industry representatives.

Expenditures for the support of the department and its constituent boards are expected to total $360 million in 1999-00, a $524,000 decrease from the current year. Included in the total are $761,000 in expenditures from the General Fund for support of the Athletic Commission—a $2,000 increase from the current year.

During 1998-99 budget hearings, one of the most contentious departmental issues was the Smog Check program administered by the DCA's Bureau of Automotive Repair. Below, we discuss the program's main components and related budget-year proposals.

OVERVIEW OF THE SMOG CHECK PROGRAM

The original framework for a statewide biennial Smog Check program was implemented in 1984 by the Bureau of Automotive Repair. Under this program, both smog (emission) testing and needed vehicle repairs were permitted at any privately owned smog test-and-repair station.

The 1990 federal Clean Air Act amendments required a somewhat different smog program in states with the worst air quality, including California. Federal regulations define a region's air quality in one of two ways:

- A geographic area that meets or exceeds a national ambient air quality standard is referred to as an *attainment area*.

- An area that does not meet this standard is a *nonattainment area*. These nonattainment areas are the focus of the federal Environmental Protection Agency (EPA).

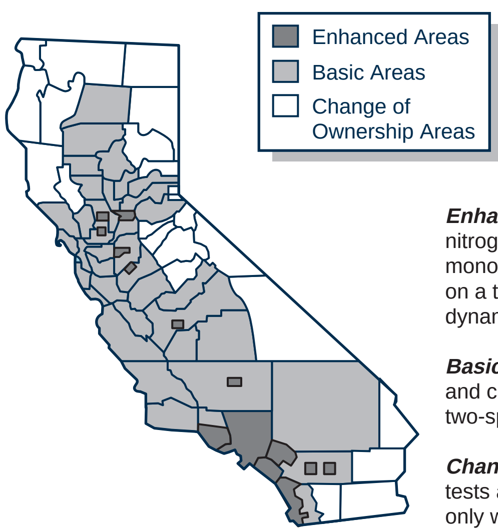
Under the 1990 act, the EPA mandated a centralized, state-owned smog check program. Under this scenario virtually all vehicles would have been initially tested at a state-owned test-only facility. Any vehicle failing the test would go to a second facility to be repaired and then, back to the test-only facility to be retested. If the vehicle failed the retest, the process would then begin again with the vehicle traveling back and forth between the test and repair facilities.

California negotiated with the federal government to adopt a modified program. This alternative program focuses on the highest polluting vehicles but is intended to be less cumbersome to the customer. The Smog Check program components as agreed to by California and the federal government are laid out in the State Implementation Plan (SIP).

The SIP was adopted by the Legislature in 1994 and approved by the federal EPA in 1996. The SIP divides California into three types of program areas based on air quality—enhanced, basic, and change of ownership. The smog test required varies by area (see Figure 1).

Figure 1

Smog Check Program Requirements Vary by Area



Enhanced Areas. Tests for oxides of nitrogen, hydrocarbon, and carbon monoxide emissions. Tests performed on a treadmill-like machine called a dynamometer.

Basic Areas. Tests for hydrocarbons and carbon monoxide only, using a two-speed idle test and tail pipe sensor.

Change of Ownership Areas. Same tests as in the basic areas but required only when a vehicle is sold.

In addition to the requirements in the SIP, the bureau administers several smog-related programs that have been adopted by the Legislature. These other nonmandated programs are the Low-Income Repair Assistance Program (LIRAP) and the Voluntary Retirement Program (VRP). The state's Smog Check program is funded from two funds—the Vehicle Inspection Repair Fund (VIRF) and the High Polluter Repair and Removal Account (HPRRA). The VIRF funds the SIP-mandated program and the HPRRA funds the other programs. A discussion of the separate elements of the state's Smog Check program and our recommendations for legislative action follows.

SIP-Mandated Components

The SIP-mandated program includes the smog testing and repair stations as well as the bureau's administrative activities (such as enforcement staff, technician licensing, remote sensing, public relations, and general administration). The *1999-00 Governor's Budget* proposes $71 million from the VIRF for the bureau's activities related to the SIP.

In addition to the bureau, two other state entities, the Inspection and Maintenance Review Committee and the Air Resources Board, have responsibilities under the SIP. Both these entities monitor the progress of the bureau in implementing the SIP and the overall effectiveness of the program in bringing California into compliance with federal air standards.

Is California on Track to Meet Clean Air Requirements?

We recommend the Legislature not approve the requested $71 million for the Smog Check program until the bureau reports to the Legislature on the status of the program and whether it is still on track for meeting the requirements of the State Implementation Plan as agreed to by the state and the federal Environmental Protection Agency. Since the Air Resources Board and the Inspection and Maintenance Review Committee are both responsible for monitoring the Smog Check program, we recommend that each provide the Legislature its assessment of the program as well.

To monitor California's performance, the SIP includes performance standards and deadlines for implementation of key SIP components. Essentially, the SIP calls for entire state to meet federal air quality standards by 2010.

California agreed to have its complete program in place by December 31, 1997. However, some components of the program have been amended by state statute, others were not implemented by the December deadline, and still others had not been implemented at the time this *Analysis* was written.

The major program elements of the SIP are discussed below, along with the status of how the state has responded to the SIP requirements. Figure 2 provides a glossary of common smog check terms.

Figure 2

Smog Check Program: Common Terms

- ***Vehicle***. Most gasoline powered automobiles and light-duty trucks must undergo a smog check biennially, at the time of registration. The major exemptions to this requirement are vehicles four model years old or newer and pre-1974 vehicles. In addition, most out-of-state vehicles registered in California for the first time must undergo a smog check. Currently, approximately 14 million vehicles are subject to the Smog Check program.

- ***State Implementation Plan (SIP)***. Smog Check program agreement between California and the federal Environmental Protection Agency.

- ***Gross Polluting Vehicle***. A vehicle that emits excessive amounts (three to ten times the allowable rate) of hydrocarbons, carbon monoxide, or oxides of nitrogen. Gross polluting vehicles represent only about 15 percent of the vehicles in California but are responsible for more than half of the smog produced by vehicles.

- ***High Emitter Profile (HEP)***. Database of vehicles and associated information on vehicle make, model, and emissions. Data are used to compose "profiles" of vehicles most likely to be gross polluters.

- ***Low Emitter Profile (LEP)***. Same database as used to compile HEPs. However, in this instance the data are used to profile vehicles with low emissions—that is, "clean" cars.

- ***Remote Sensing***. Device that uses an infrared beam to scan a vehicle's exhaust to test for pollutants.

- ***Dynamometer***. Treadmill-like machine used to test vehicles in enhanced areas. Most closely simulates actual driving conditions and can test for all three smog components—hydrocarbons, carbon monoxide, and oxides of nitrogen.

- ***BAR-90 Test***. Smog test used in basic and change-of-ownership areas. Tests only for hydrocarbons and carbon monoxide, using a two-speed idle test and tail pipe sensor.

Smog Test Stations

The SIP requires California to implement a hybrid testing program that includes test-only stations and the conventional test and repair stations. The California system includes four station designations:

- *Test-Only* stations can only perform smog tests.
- *Gold Shield Certification* stations can test, repair, and retest all vehicles.
- *Gold Shield Guaranteed Repair* stations can test and repair vehicles. These stations also guarantee repairs on gross polluting vehicles.
- *Test and Repair* stations can test, repair, and retest vehicles—but cannot retest gross polluting vehicles. (A gross polluter must go to a test-only station to have the final test conducted.)

Status of Smog Test Stations. The major change resulting from the SIP was establishing the test-only network. Under the SIP, the test-only network of stations was to begin in 1995 and a percent of vehicles, as determined by the bureau, in the enhanced areas were to be sent to test-only stations. The network did not begin until September 1998. Currently about 15 percent of the vehicles in enhanced areas of the state are directed to test-only stations.

Remote Sensing

The SIP requires an on-road testing program using remote sensing devices. The program is designed to monitor vehicles as they are driven on the state highways. According to the SIP, the sensing units would be set up at various points throughout the enhanced areas. If a vehicle driving past the sensing unit was tested as gross polluting, the vehicle would be pulled to the roadside and tested using a BAR-90 machine. If the BAR-90 test confirmed that the vehicle was a “gross polluter” the vehicle owner would be required to repair the vehicle and pass a smog test.

In addition, the data compiled from this program was to be incorporated into the high- and low-emitter profiles. The bureau was to use the high-emitter profile to direct vehicles to the test-only stations for the biennial test and use the low-emitter profile to exempt vehicles from the biennial test.

Status of Remote Sensing. During 1996, the bureau conducted an on-road testing pilot program. The program did not require that the vehicle undergo a BAR-90 test. The bureau has not been operating any remote sensing devices for the past two years in part because the bureau was not satisfied with the device accuracy from the pilot program. The bureau is currently using the high-emitter profile to direct vehicles to test-only stations but has not used the low-emitter profile.

Oxides of Nitrogen

Under the SIP, the program in the enhanced areas must test for three different pollutants: carbon monoxide, hydrocarbons, and oxides of nitrogen (NOx). The NOx is a key component of smog and ozone formation. Therefore, reducing NOx emissions is crucial to meeting the federal air quality requirements.

Status of Testing for NOx. Testing for NOx was to be implemented by December 31, 1997. However, the testing was delayed until September 1998. Also, once NOx testing began, the level at which a vehicle would fail was set very high to avoid failing a large number of vehicles. We understand the bureau is gradually adjusting the failure points toward the level necessary to meet the federal requirements.

Annual Testing

The SIP requires annual testing of gross polluters and vehicles that are found to have tampered emission systems. Most other vehicles are tested biennially when registering with the Department of Motor Vehicles.

Status of Annual Testing. The authority for the bureau to require annual tests was repealed.

LEGISLATURE NEEDS UPDATE ON PROGRAM

Based on the discussion above, we believe the bureau, in conjunction with the Air Resources Board and Inspection and Maintenance Review Committee, should report to the Legislature on the status of the Smog Check program and whether the program is still on track for meeting the requirements of the SIP. Further, we recommend the Legislature not approve funding for these elements of the Smog Check program until this information is received and reviewed.

Non-SIP Program Components

We withhold recommendation on the $62 million and 91 personnel-years for the Low-Income Repair Assistance and Voluntary Retirement programs pending receipt and review of an evaluation report.

The non-SIP program consists of two legislative initiatives—the LIRAP and the VRP. These programs are funded from the HPPRA. This account is funded by revenue received from the smog impact fee—a $300 fee paid when an out of state vehicle is registered in California for the first time. The *1999-00 Governor's Budget* proposes $62 million from the HPRRA for these programs. The bureau is planning to submit evaluation reports for both programs prior to budget hearings.

The LIRAP. Chapter 804, Statutes of 1997 (AB 57, Escutia) authorizes the bureau to offer a repair-assistance program to qualifying low-income motorists. The program was established to provide state-funded repair assistance to certain vehicle owners. The program began in a test region (Sacramento County) in November 1998. Vehicle owners must meet the following criteria to be eligible for participation in this program:

- California vehicle owners at or below 175 percent of federal poverty.
- Vehicle has failed a biennial smog check.
- Vehicle owner has contributed at least $250 toward repairs.

If the vehicle owner meets the above criteria the state will contribute up to an additional $450 towards the necessary repairs.

At the time this *Analysis* was written, three motorists had participated in the LIRAP. The bureau was planning to expand into the San Diego and Los Angeles areas by February 1, 1999 and statewide by Spring 1999.

The VRP. The VRP was authorized by Chapter 28, Statutes of 1994 (SB 198, Kopp). This program provides vehicle owners with another option if their vehicle fails its biennial smog check and is a gross polluter. That is, the state will pay participants up to $450 to retire their vehicle. Essentially if a vehicle owner decides to participate in the VRP, the vehicle is sold to a private scrap dealer and must be scrapped. There are no income restrictions on VRP participation. The VRP began statewide in November 1998. At the time this *Analysis* was written, program data were not available.

We withhold recommendation on the $62 million requested for these programs pending receipt and review of the bureau's evaluation reports.

Remote Sensing Funding and Transfers

We recommend the Legislature not approve any funding for remote sensing until the bureau provides (1) an accounting of the current-year remote sensing appropriation and (2) a complete plan for the uses of and schedule for remote sensing.

In our *1998-99 Analysis* (see page G-26) we raised issue with the bureau's continual budget redirections from remote sensing to other uses and the time frame for implementing remote sensing. The Legislature partially addressed that concern by scheduling (under Provision 1 of the budget act item) the remote sensing appropriation for the current year and adopting supplemental report language specifying the purpose of the remote sensing program. However, the bureau does not have any remote sensing units in operation and does not plan to have any in operation until the budget year. Despite this, the Governor's budget indicates that the entire current-year appropriation ($5.3 million) will be spent. If the bureau is not implementing remote sensing, it should provide a detailed accounting of those funds. In addition, the bureau needs to provide the Legislature with a detailed plan for the uses of and schedule for implementation of remote sensing. We recommend the Legislature not approve any funding for remote sensing until this information is received and reviewed.

Bureau Enforcement Program

We recommend the bureau provide information regarding the enforcement activity (such as undercover audits and licensee investigations) it currently performs. This information should include a discussion of the bureau's assessment of the necessary level of enforcement and justification for the requested 20 percent increase.

The bureau investigates and enforces violations of the Smog Check program by motorists and licensed stations and technicians. One of the tools it uses is covert performance audits of smog check stations and technicians. Similar to remote sensing, the enforcement appropriation was scheduled in the *1998-99 Budget Act*. The Governor's budget proposes $17.9 million for enforcement, a 20 percent increase over the current-year appropriation. We recommend the bureau provide information regarding the enforcement activity (such as undercover audits and licensee investigations) it currently performs. This information should include a discussion of the bureau's assessment of the necessary level of enforcement and a justification for the requested increase.

Legislative Oversight and Program Accountability

We recommend the Legislature add separate items to the budget bill for the Smog Check program appropriations, including the Low-Income Repair Assistance and Voluntary Repair Program, to enhance legislative oversight and improve visibility and accountability of the programs.

The bureau's funding from both the VIRF and HPRRA was scheduled in the *1998-99 Budget Act*. However, this schedule is not provided in the *1999-00 Budget Bill*. Instead the appropriations from these two funds are shown as lump-sum amounts and are then transferred, with appropriations from several other funds, to the DCA under the DCA Fund.

Consistent with legislative action last year to improve oversight and accountability of the program, we recommend that the Legislature add new items to the budget bill for the programs. Because the two funds are available exclusively for the various components of the Smog Check program, the appropriations should be kept separate from the department's other appropriations and the current authority to transfer the schedule should be deleted. Therefore, we recommend the Legislature add items 1111-001-0421 and 1111-001-0582 to the budget bill. Once the budget committees have taken action on the bureau's budget, we will develop the item schedules to reflect those actions.

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL (2100)

The Department of Alcoholic Beverage Control (ABC), established by constitutional amendment in 1954, administers the Alcoholic Beverage Control Act. Under the act, the ABC has the exclusive authority, in accordance with laws enacted by the Legislature, to license and regulate the manufacture, sale, purchase, possession and transportation of alcoholic beverages in California, and to collect licensing fees. The ABC also has the authority to deny, suspend, and revoke licenses.

The Governor's budget proposes $33.3 million for support of the ABC in 1999-00 from the ABC Fund ($32.1 million) and reimbursements ($1.2 million). Included in this amount is $1.5 million for local assistance which is the same as the current year. In total, the proposed budget is less than a 1 percent increase.

ABC Fund Condition

We recommend the Legislature enact legislation allowing the Department of Alcoholic Beverage Control to increase license fees to sustain current enforcement levels and avoid budgetary shortfalls.

The Alcohol Beverage Control Fund receives revenues from 61 different types of manufacturer, importer, retail, and wholesale liquor licenses. The ABC currently monitors over 70,000 licensees. Estimated net revenues to the fund in 1999-00 are $31.1 million.

Based on current-year and proposed budget-year expenditures and revenues, the ABC Fund will end the budget year with approximately $2.7 million in reserve. This represents approximately one month's operating expenses for ABC. This is substantially less than the $8 million that would be needed to maintain what is usually considered to be a prudent special fund reserve of three months' operating costs. Furthermore, by

2001-02 the amount in the fund will not cover the department's projected expenditures.

Consequently, based on current revenue and ABC enforcement activities the department needs either to (1) increase operating revenue or (2) reduce expenditures to remain solvent in future years. The Legislature has recently acted to increase the department's enforcement activities. If the Legislature wants to sustain this level of activity, then license fees will have to be increased.

History of ABC License Fees. The license fee revenue deposited in the ABC Fund is the total of a base license fee established in 1955 and four increases since 1955:

- In 1978—a 10 percent surcharge to account for inflation.
- In 1983—a 6 percent surcharge to pay for administrative hearings.
- Also in 1983—a 3 percent surcharge to fund the Alcoholic Appeals Board. These funds go directly to the board and are not available to the ABC.
- In 1991—a $5 assessment against most licensees was added to fund designated driver education programs under the California Highway Patrol. These funds are used exclusively by the highway patrol.

Figure 1 (see next) depicts the current license fee schedule for the nine ABC license categories that represent 94 percent of all ABC licensees. The fees are paid on an annual basis and are the same for original and renewal licenses.

Fee Adjustment. The ABC, as a regulatory agency, is appropriately funded by industry fees. Periodically, regulatory agencies must evaluate their fee schedule and adjust fees upward (for example, to account for inflationary pressures and new budget initiatives) or downward (for example, when a fund balance gets too high). In the ABC's case, operating costs have increased because of inflation and increased enforcement activities yet the license fees have not kept pace with these costs. As discussed above, these fees have not been adjusted for inflation since 1978. To illustrate the impact of that on the department, we estimate that if license fees were adjusted solely to reflect inflation since 1978, the department currently would have about $54 million in additional revenues.

Figure 1

Alcoholic Beverage Control Selected License Fees

License Type	Base Fee Amount	Total Increase Since 1955	Total
Beer and wine wholesaler	$56	$16	$72
Retail package off-sale beer and wine	24	10	34
Retail package off-sale general	350	72	422
On-sale beer	168	37	205
On-sale beer and wine	168	37	205
On-sale beer and wine—public premise	168	37	205
On-sale general license—eating place[a]	360-580	74-115	434-695
On-sale general license—public premise[a]	360-580	74-115	434-695
Caterer's permit—club[a]	360-580	74-115	434-695

[a] License fees vary by city population.

Ideally, the ABC fee structure should generate sufficient operating revenue to fund needed ABC operations and establish a reasonable reserve. In addition, because ABC fees are set in statute, the fees should be structured with sufficient flexibility to periodically adjust the fees to match the enforcement activities and associated budget approved by the Legislature.

Given the department's current tight budgetary situation, we recommend that the Legislature amend the Alcoholic Beverage Control Act to permit the ABC to increase fees. We would suggest giving the department the ability to raise fees *up to* 20 percent over a multiyear period. Clearly, only a small increase would be needed in the near term. We further recommend that any fee increase be conditioned on the need to increase fees only to meet the budget expenditure level *approved by the Legislature* and necessary to maintain a prudent operating reserve.

OFFICE OF REAL ESTATE APPRAISERS (2310)

The Office of Real Estate Appraisers (office) was established in 1990 when the Legislature enacted the Real Estate Appraisers' Licensing and Certification Law. However, this program is markedly different from other state licensing programs because real estate appraisers are not required to be licensed in order to practice in California. The licensing program was established to respond to a federal mandate that appraisals for federally related transactions be completed by a state licensed or certified appraiser and that the state certification and licensing program meet certain requirements. In addition, the office is responsible for investigating complaints against licensees and certificate holders.

The *1999-00 Governor's Budget* proposes $4.2 million from the Real Estate Appraisers Regulation Fund for support of the office. This is $200,000, or 0.5 percent, above current-year expenditures. The majority of the revenue to this fund is from license and examination fees.

Fund Balance and Revenue

We withhold recommendation on the proposed budget for the Office of Real Estate Appraisers pending receipt and review of a strategic budget plan.

Based on current expenditures and revenues, the office is projected to end the budget-year with a fund reserve of slightly more than $500,000. For special fund agencies it is important to maintain a fund balance equal to approximately three months operating expenses. A prudent reserve of this amount would provide an agency sufficient resources to meet cash flow needs and to cover unexpected expenses. For the office a three-month reserve would total slightly more than $1 million.

As mentioned above, the majority of the revenue to the Real Estate Appraisers Regulation Fund is license and examination fees. Licenses are renewed on a four-year cycle. Our analysis indicates that the Real Estate Appraisers Regulation Fund is currently operating with a budget imbalance. Essentially, revenues are not sufficient to keep pace with expenditures. For example, over the period

1996-97 to 1999-00 (a complete license cycle) revenue to the fund totaled $9.3 million and expenditures from the fund totaled $15.5 million—a substantial imbalance. The office has managed to remain solvent during this time because it had a large fund reserve from which to draw. As we indicate above, this reserve will almost be depleted by the end of the budget year.

Since the bulk of licensees were licensed in the original year of the program, the office receives a disproportionately large share of its revenue every fourth year. This will next occur in 2000-01 when the office is projected to receive approximately $4.8 million in revenue. Based on current expenditure trends, the office will spend about half the total renewal revenue in that fiscal year. This would leave the office with insufficient revenue to operate over the subsequent three years.

It is our understanding that the administration is currently preparing a proposal for the office that will address this budget imbalance. The proposal should be available for review by the Legislature during budget hearings. We recommend the office include a five-year strategic budget plan in its proposal. The budget plan should include, at minimum:

- A cash flow analysis of the proposed budget for 1999-00 and subsequent years.
- A five-year (1999-00 as the first year) budget showing expenditure and revenue levels sufficient to meet the office's mission. This is a crucial component of the plan. At this time it appears that the office's *current* fee structure does not generate revenues sufficient to fund the office's current level of activities. However, we are not certain what staffing and related resource levels are needed for the office to fulfill its mission.

If the office's proposal includes a fee increase, the office should provide adequate justification for that increase, including a comparison of California fees with other states. We withhold recommendation on the 1999-00 proposed budget until receipt and review of a strategic budget plan, as described above.

1998 Audit Report and Findings

The office should, prior to budget hearings, provide a detailed update of the office's progress in responding to the concerns raised in the March 1998 State Auditor report.

In March 1998, the State Auditor released a report that raised issue with several practices within the office. The major problems found were that the office (1) had a large backlog of complaints that it had been unable to resolve promptly, (2) certain personnel practices violated state and federal rules, and (3) some investigatory procedures needed to be improved.

As a result of the issues raised by the Auditor, the Legislature adopted several supplemental reporting requirements for the office. The office also was required to submit quarterly reports tracking its progress in responding to the Auditor's finding. The first two quarterly reports have been received and the issues raised by the Auditor have been addressed as described below.

Complaint Backlog. The Auditor found that as of January 1, 1998, the office had 641 open complaints. Some of these complaints had been open for as long as four years. The Auditor found that a major contributing factor to the office's inability to process complaints was that the office did not establish the enforcement division in a timely manner. Also, once established, the enforcement division was not fully staffed and was staffed with limited-term employees rather than the permanent employees authorized by the Legislature.

Based on information in the second quarterly report compiled by the office, vacancies in the office have been filled with permanent employees. Furthermore, as of December 1, 1998 the office had closed out 567 of the 641 outstanding complaints. In addition, the office has closed out 93 of the complaints that were received in 1998.

Personnel Practices. The Auditor found that (1) the office's use of limited-term appointments was not in accordance with State Personnel Board rules and (2) the office's overtime practices violated provisions of the Fair Labor Standards Act. As mentioned above, the office has now filled all vacant positions with permanent employees and has paid all current employees entitled to overtime compensation in accordance with Department of Personnel Administration rules. However, the office has been named in a civil suit filed by two former employees alleging violations of the Fair Labor Standards Act. At the time this *Analysis* was prepared, the case was pending in federal district court.

Investigatory Procedures. The State Auditor found that the office was not recording the necessary investigatory information and the investigators needed training to ensure the office was investigating complaints using consistent methods. In response, the office has provided all investigators with training on proper record keeping, has established procedures for investigation of complaints, and implemented oversight safeguards to ensure staff comply with the new procedures.

It appears from the information received in the first two quarterly reports that the office is being responsive in addressing the issues found by the Auditor. The third quarterly report is due to be submitted March 1, 1999—during budget hearings. We recommend the office report to the appropriate budget subcommittee regarding its progress in responding to the issues raised in the 1998 State Auditor's report.

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 demand, developing and implementing energy conservation measures, conducting energy-related research and development programs, and siting major power plants.

The budget proposes commission expenditures of $227.7 million from various state and federal funds in 1999-00. This is $10.8 million, or 4.5 percent, less than current-year estimated expenditures. This reduction is due in part to one-time expenditures in the current year for a variety of projects that are not carried forward to the budget year. These reductions are partially offset by increased expenditures in the budget year of (1) $2.5 million for the Energy Facilities Siting Program and the Public Interest Energy Research (PIER) Program and (2) $0.6 million in the Energy Technology Development Program.

Legislature Needs to Review Energy Facilities Siting Program

We withhold recommendation on the request for a $1,247,000 augmentation and ten positions for the Energy Facilities Siting Program until the Legislature reviews the commission's role in siting energy facilities under the deregulated market for electricity generation. We further withhold recommendation on the existing staffing level and funding (75 positions and $9.5 million) for the siting program, pending the Legislature's review of the commission's siting role.

The budget proposes $1,247,000 from the Energy Resources Programs Account for the commission's Energy Facilities Siting Program. These funds would be used to establish ten permanent positions and provide $400,000 for consultant contracts, $60,000 for travel expenses, and $20,000 for overtime expenses. The proposal is based on the commission's projection of increased workload related to reviewing energy facility siting applications the commission currently expects to receive through December 2000.

This request would permanently establish the ten positions and the $400,000 in consulting funds the Director of Finance proposed in a December 1998 deficiency proposal submitted to the chairs of the appropriations committees in each house and the Chair of the Joint Legislative Budget Committee. The proposal, submitted pursuant to Section 27.00 of the *1998-99 Budget Act*, was to address an increase in siting workload the commission expected to occur before the end of the current year. The Chair of the Joint Committee did not concur with the Director's proposal. Instead, the Chair advised the Director to increase the commission's expenditure authority only for the current year with the conditions that (1) the ten positions not be permanently established and (2) the commission be given the flexibility to use the entire amount for consultants if this would facilitate its review of siting applications. The Chair indicated that this would give the commission the resources needed to continue its current responsibilities in 1998-99 while providing the Legislature an opportunity to reassess the commission's role in and funding for the siting activity during the budget hearings.

The Warren-Alquist Act requires the commission to approve the construction of electricity-generating power plants, unless the plant generates less than 50 megawatts of electricity or is a hydroelectric, wind, or solar facility. After approving a proposed power plant, the act requires the commission to ensure that the facility is in compliance with all applicable federal, state, and local laws, as well as any conditions of certification required by the commission. The commission must approve any modifications to these plants. For plants not subject to its jurisdiction (such as those that predate the siting approval process), the commission must approve plant modifications unless the modifications meet the megawatt or type-of-facility exclusions outlined above.

In 1996 and 1997, the Legislature significantly changed the way the electricity industry is regulated in California. These changes included deregulation of the generation of electricity and creation of statewide entities to ensure the availability of electricity and the reliability of the statewide electricity system. The changes did *not* deregulate the transmission or distribution of electricity.

In the newly deregulated environment for electricity generation, the state's regulatory interest in approving the construction and modification of facilities may have changed. Therefore, it is not clear which, if any, of the commission's siting activities are still necessary or what benefits these activities continue to provide. Until the Legislature reviews the commission's role in siting energy facilities under the deregulated market for electricity generation, the appropriate funding level for these activities is uncertain. Consequently, we withhold recommendation on the request for ten positions and $1,247,000 for the Energy Facilities Siting Program. We also withhold recommendation on the existing staffing level and funding—75 positions and $9.5 million—dedicated to the Energy Facilities Siting Program, pending the Legislature's review of the commission's siting role. Prior to the budget hearings, the commission should submit to the Legislature a report that (1) discusses each of the commission's siting activities; (2) discusses which siting activities should continue, be amended, or be eliminated; and (3) justifies the commission's conclusions.

DEPARTMENT OF FOOD AND AGRICULTURE (8570)

The California Department of Food and Agriculture promotes and protects the state's agriculture industry through industry inspections and marketing support; develops California's agricultural policies; assures accurate weights and measures in commerce; and provides financial oversight to county, district, and citrus fairs.

The *1999-00 Governor's Budget* proposes $201 million for the department, which is about $600,000 higher than current-year expenditures. The proposed budget includes $70.5 million from the General Fund, a 1 percent decrease from the current year.

CALIFORNIA VETERINARY DIAGNOSTIC LABORATORY SYSTEM

The budget proposes $11.5 million, including $9.7 million General Fund, for operations of the California Veterinary Diagnostic Laboratory System. The laboratory was established in 1918 and was operated as a program within the department until 1987-88, when the University of California at Davis took over responsibility for its management. The department contracts with the laboratory for services and separately displays the General Fund amount for the laboratory in the Governor's budget but not in the budget bill.

Fee Structure

We recommend the Legislature require the department to implement a fee schedule that provides for 100 percent cost recovery for the testing services provided by the Veterinary Diagnostic Laboratory for (1) regulated industries (this action would result in a decrease in needed General Fund support of an unknown amount) and (2) private veterinarians and producers (this would result in a decrease in needed General Fund support of $93,000 annually). (Reduce Item 8570-001-0001 by $93,000.)

Currently, laboratory operations are funded through a combination of General Fund, fee revenue, and federal funds. The majority of the budget, 84 percent, is funded by the General Fund. The fee revenue, estimated to total $1.6 million in 1999-00, is generated by testing services provided to private veterinarians and producers. In recent years, issues have been raised regarding the payment for these laboratory services.

In the *Supplemental Report of the 1998-99 Budget Act*, the department was required to submit information on how the state should recover the cost of the contract with the laboratory. In December 1998, the department submitted the required report, detailing the current fee and workload structure and providing funding alternatives and recommendations. The laboratory's workload structure is based on the different clients served by the laboratory. Basically, the laboratory performs both regulatory and nonregulatory or diagnostic testing services.

- *Regulatory* services are those provided to the department for state and federal regulatory programs (such as tests for food quality, animal diseases, and human pathogens). These tests are primarily funded by the General Fund.
- *Nonregulatory* or diagnostic services are those provided primarily to practicing veterinarians and agricultural producers and are generally paid for through user fees.

Regulatory Programs. The laboratory performs testing as a part of several regulatory programs. These programs vary from equine postmortem examinations to E. coli and Salmonella monitoring for the department's milk quality assurance program. As with other regulatory programs, it would be appropriate for the regulated industries to pay these costs. Thus, these testing services should be entirely funded through industry fees rather than the General Fund. We recommend the Legislature require the department to establish a fee schedule for the regulatory programs to provide for 100 percent cost recovery. Since these services are currently supported by the General Fund, this action would result in a reduction in the needed General Fund support for the department. The department should provide an estimate of this amount prior to budget hearings.

Nonregulatory Programs. According to information submitted by the department, approximately 80 percent of the cost for tests performed primarily for benefit of agricultural producers is currently recovered by fees. Thus, the General Fund is subsidizing about 20 percent of these costs. One of the recommendations in the department's December report is to "implement a plan to recover 100 percent of the costs from tests which primarily benefit producers." We concur with this recommendation. The laboratory estimates that doing this would have resulted in approximately $93,000 of additional fee revenue in 1997-98. Thus, we recommend the Legislature direct the laboratory to make the needed adjustment in fees and consequently reduce the budget to reflect the resulting reduction in General Fund support needed for current laboratory operations. (Reduce Item 8570-001-0001 by $93,000.)

Legislative Oversight of Veterinary Laboratory Budget

We recommend that the Legislature create a new budget bill item under the Department of Food and Agriculture in order to separately identify the laboratory's operating costs and to enhance legislative oversight. (Delete $9,709,000 from Item 8570-001-0001 and add Item 8570-0004-0001 in the amount of $9,616,000.)

The General Fund appropriation for the laboratory, while displayed in the Governor's budget, is not identified in the budget bill. Because of legislative concern over recent cost increases and to increase the visibility and accountability of the laboratory budget, we recommend the Legislature add a separate item to the budget bill to appropriate funds for the laboratory budget. Thus, we recommend the Legislature add the following item to the budget bill (the amount shown reflects a $93,000 reduction, as discussed above).

8570-004-0001—For support of the Department of Food and Agriculture for the California Veterinary Diagnostic Laboratory, pursuant to Food and Agriculture Code Section 520, et. seq..........$9,616,000.

FAIR POLITICAL PRACTICES COMMISSION (8620)

The Fair Political Practices Commission (FPPC) was established in 1974 to implement and administer the Political Reform Act (PRA), an omnibus measure designed to improve the elections process in California for candidates for state and local office. The act (1) established rules for the disclosure of money received and spent by candidates seeking political office, (2) required state ballot pamphlets to have useful and understandable information, (3) established lobbyist activity disclosure regulations, and (4) required the disclosure of assets of public officeholders and barred conflicts of interest with their official decision making. The California Political Reform Act of 1996 (CPRA), established by Proposition 208, among other provisions established specific limits on the amount and source of campaign contributions and established voluntary campaign spending limits for candidates.

The provisions of the PRA and CPRA are carried out by four state agencies, including the FPPC (the other agencies are the Secretary of State, Department of Justice, and the Franchise Tax Board). The FPPC adopts regulations, establishes procedures to monitor compliance, and provides advice to officeholders regarding the requirements of the PRA and CPRA. The FPPC also investigates alleged violations of the laws and imposes sanctions on violators.

The PRA provided a $1 million annual appropriation to the FPPC. The CPRA provided an additional $500,000 annual appropriation to the commission. By law, the amounts are to be adjusted each year for changes in the cost of living. The PRA further directs that the Legislature shall provide such additional amounts as may be necessary to the FPPC and other state agencies to carry out the political reform laws.

The budget proposes total expenditures of $5.1 million for the FPPC in 1999-00. This is almost exactly the same amount the commission is estimated to spend in the current year.

Further Efforts Needed To Comply With Audit

The Fair Political Practices Commission (FPPC) has made significant progress toward implementing the recommendations of a May 1998 Bureau of State Audits (BSA) report to make its operations more efficient and effective. However, the FPPC has not yet fully complied with legislative directives to carry out the BSA recommendations to strengthen its political reform enforcement efforts. We recommend that the FPPC provide additional information to the Legislature by April 1, 1999 on how it will do so. We further recommend enactment of legislation that would allow the FPPC to more narrowly focus its enforcement efforts on the most serious violations of political reform laws and to strengthen the penalties that it can impose when such violations occur.

Last year, the Legislature directed the BSA to examine the operations of the FPPC and report on how well it was performing its duties. In its May 1998 response, the BSA found that the FPPC was reasonably interpreting the PRA in its regulation and advice to candidates and public officeholders, but that its process for investigating complaints was flawed and could result in inconsistent treatment of violators. The BSA report also found problems in the way the FPPC provided assistance to persons seeking information about political reform laws, determined that the FPPC lacked meaningful goals and a system to measure progress toward meeting those goals, and concluded that financial disclosure and conflict-of-interest laws for state and local officeholders enforced by the FPPC contained overly restrictive financial limits that should be modified.

The Legislature adopted *1998-99 Budget Act* and supplemental report language directing the FPPC to implement BSA's recommendations for remedying these problems. The language further directed the FPPC to complete a plan by December 1, 1998 identifying how it would implement each specific recommendation and the additional funding and staffing, if any, necessary to carry out the audit recommendations.

Progress Seen in Audit Compliance. Based upon our analysis, the FPPC has taken some significant steps toward improving its operations as recommended by the BSA:

- ***Prioritized Case Reviews.*** The cases being considered for investigation are being reviewed using standard criteria to determine which are a high priority and warrant immediate assignment and which are a lesser priority.
- ***Auditing Regulations.*** New regulations have been written so that the Franchise Tax Board, charged by state law with conducting

audits of candidate and lobbyist financial disclosure statements, will refer only the most significant law violations it has found to the FPPC for enforcement action and will not be required to perform audits unlikely to discover significant violations.

- ***Local Filing Oversight.*** A plan is being written to provide oversight for an estimated 7,000 officials responsible for ensuring that local government officeholders comply with financial disclosure requirements.
- ***Tracking Customer Needs.*** Coding devices were installed on FPPC phones so that staff members responsible for assisting persons with obtaining forms or clarifying the meaning of political reform laws could track what kind of help they needed most from the FPPC so that customer service could be improved.

Partial Compliance. As directed by the Legislature, the FPPC submitted a plan to the Legislature on December 1, 1998, outlining the steps taken so far to comply with the BSA audit recommendations. As the Legislature also directed, the FPPC identified the staffing and funding it believes are needed to implement certain audit recommendations—in all, 13 positions and $840,000.

However, our analysis indicates that the FPPC has not yet fully complied with legislative directives to carry out the BSA recommendations to strengthen its political reform enforcement efforts.

In a few cases, the FPPC failed to identify the staffing or funding it says are needed for fulfillment of BSA recommendations. This was the case for new computerized management information system that FPPC asserted was needed so that achievement of its goals can be tracked and measured.

In other cases, the FPPC reported how much staffing or funding it wanted for BSA compliance activities, but failed to document exactly how the money would be used and the workload justification for requesting additional resources. For example, the FPPC said it would need six additional staff and $437,000 for its Enforcement Division, but could not document how its workload was determined or why it could not be handled with its existing complement of investigators. Without this information, the Legislature cannot easily determine whether additional appropriations to FPPC are justified to carry out its directive for improving the enforcement of the political reform laws. The proposals contained in the report were requested by FPPC for inclusion in the 1999-00 budget, but were rejected.

Financial Limits Too Low. As noted earlier, the 1998 BSA audit report also recommended modification of the dollar limits established for state or local officeholders who must disclose their financial interests or refrain from decision-making in which they might have a conflict of interest.

For example, an officeholder may not participate in a governmental decision if he or she received more than $250 from a party with an interest in the matter. The $250 limit was part of the original 1974 PRA and has never been adjusted for inflation. The BSA concluded that the public interest would be served if the limit were adjusted for inflation, because it would allow the FPPC to more narrowly focus on the enforcement of the most serious violations instead of a large number of complaints involving minor violations. A measure to change these financial limits (AB 1864, Papan) passed the Legislature last year but was vetoed by the Governor because of his objection to an unrelated provision.

Meanwhile, the maximum administrative or civil fine that can be imposed for a single violation of the PRA also remains at the original $2,000 level established 25 years ago. If the limit were adjusted for inflation, it would now be a maximum of about $7,000 per violation. We are advised by the FPPC that, because this penalty has not been adjusted for inflation, the fine level may be insufficient to deter some candidates and officeholders from complying with political reform laws.

Focusing Audit Activities. In response to the BSA audit, the FPPC has identified two other proposed statutory changes that would focus political reform auditing activities on the cases most likely to discover violations of political reform laws. The first measure would allow fewer audits each year of lobbyists and lobbyist employers so that more such audits could be conducted of political campaigns, where political reform law violations are more frequently found. The other would eliminate some audits of candidates' prior campaign disclosure statements that are now mandatory but that the FPPC believes should be conducted only if there is evidence of past misconduct.

Analyst's Recommendation. We believe that additional appropriations proposed by the FPPC to carry out the recommendations of the BSA have not yet been justified. Accordingly, we recommend that by April 1, 1999, the FPPC provide the Legislature with the following information: (1) identification of the funding and staffing needed for compliance with *all* of BSA's recommendations, (2) its methodology for calculating the workload and additional resources needed for each of these funding and staffing requests, and (3) an estimated timetable for completing the implementation of the BSA recommendations. Once the Legislature has received this information, it can determine whether the 1999-00 budget for the FPPC should include additional resources needed to fulfill its policy goals of strengthening enforcement of the PRA.

We also believe that the Legislature should enact legislation to make three changes to the PRA that would likely result in more efficient enforcement of the act and help deter individuals from violating the political reform laws. Specifically, we believe that the Legislature should adjust various financial limits contained in the PRA for inflation since 1974. Similarly, the maximum fine for a single political reform law violation should be adjusted from the present level of $2,000 to $7,000 to account for inflation over the same period. The additional fine revenues generated would go to the state General Fund, not to the FPPC directly, but could help offset the potential cost of improving the FPPC's operations.

PUBLIC UTILITIES COMMISSION
(8660)

The Public Utilities Commission (PUC) is responsible for the regulation of privately owned "public utilities," such as gas, electric, telephone, and railroad corporations, as well as certain passenger and household goods carriers. The commission's primary objective is to ensure adequate facilities and services for the public at equitable and reasonable rates. Throughout its various regulatory decisions, the commission also promotes energy and resource conservation.

The budget proposes total expenditures for PUC in 1999-00 of $83.7 million from various state special funds ($70.9 million), federal funds ($1 million), and reimbursements ($11.8 million). This is about $26.9 million, or 24 percent, less than estimated current-year expenditures. This decrease results from a one-time current-year appropriation of $28 million from the General Fund for electric utility purposes in San Diego and San Francisco and an increase of $1.1 million in rate regulation activities funded by the Public Utilities Commission Utilities Reimbursement Account.

Funding for Compliance With "Cramming" Statutes

We withhold recommendation on the $1,035,000 augmentation and 19 positions requested to comply with Chapter 1041, Statutes of 1998 (SB 378, Peace) and Chapter 1036, Statutes of 1998 (AB 2142, Brown), which address the problem of "cramming," pending receipt and review of additional workload data to justify the requested staffing level and associated funds.

The budget proposes expenditures of $1,035,000 and the addition of 19 two-year limited-term positions to support PUC workload resulting from Chapter 1041 and Chapter 1036. This legislation addressed the problem known as "cramming," or the inclusion of unauthorized charges on telephone bills. The legislation requires PUC to document consumer complaints and investigate companies that receive a specified level of complaints. The legislation also allows PUC to investigate companies below this complaint threshhold at the commission's discretion.

Initial information provided by PUC with the request did not provide sufficient data to support the need for the requested 19 positions and related costs. The PUC staff subsequently submitted more detailed information to justify the request, but we received this information too late to thoroughly review it prior to writing this analysis. Consequently, we withhold recommendation on the request pending further analysis and review.

BOARD OF EQUALIZATION
(0860)

The Board of Equalization is one of California's major tax collection agencies. The board (1) collects state and local sales and use taxes and a variety of business and excise taxes and fees (including those levied on gasoline, diesel fuel, cigarettes, and hazardous wastes) and (2) is responsible for allocating tax proceeds to the appropriate local jurisdiction(s). The board oversees the administration of the property tax by county assessors and assesses property owned by public utilities. The board is also the final administrative appellate body for personal income and bank and corporate taxes, as well as for the taxes it administers. The agency is governed by a five-member board—four-elected members and the State Controller.

The *1999-00 Governor's Budget* proposes approximately $291 million in support of the board's operations, of which $184 million is from the General Fund. The total proposed budget expenditures are about 2 percent above current-year expenditures.

Audit and Collections Program Augmentation Not Justified

We withhold recommendation on the proposed $6 million ($4.9 million General Fund) augmentation and 116 new audit positions until the agency provides sufficient justification for this increased audit effort. (Reduce Item 0860-001-0001 by $4,898,000 and Item 0860-501-0995 by $1,076,000.)

The Governor's budget proposes the addition of 116 audit positions and $6 million ($4.9 million General Fund). According to information prepared by the Department of Finance (DOF), the proposed augmentation would result in an additional $12.9 million in state and local tax revenue in the budget year. Our analysis indicates that this level of additional revenue is overstated. The DOF has not fully discounted the projected revenue to account for the delay in hiring new auditors, training the new auditors, and the costs and delays associated with collections. Taking these factors into account, we estimate that budget-year collections would total $9 million to $10 million.

In the past we have raised concerns with the board justifying audit staff augmentations based on potential revenue gains, noting that the Legislature has not had sufficient information to review the validity of the methodology used by the board to make revenue impact calculations. The State Auditor, at the request of the Legislature, is evaluating the revenue (assessments and collections) benefit of additional tax auditors. This report should be available for review within a few months.

At this time, we withhold recommendation on this proposal. As noted above, the benefits to the state may be considerably less than stated and the auditor's report may offer important information to help the Legislature make decision on these requests. There is an additional issue that, in our view, deserves more attention: the level of audit exposure for taxpayers. The Legislature should take into account whether the costs of the additional audit activity is worth the improvement in taxpayer compliance and whether the greater audit "presence" in the state is appropriate. We recommend that the agency also explicitly address these issues.

FRANCHISE TAX BOARD
(1730)

The Franchise Tax Board is one of the state's major tax collecting agencies. The department's primary responsibility is to administer California's Personal Income Tax and Bank and Corporation Tax laws. The department also administers the Homeowners' and Renters' Assistance programs and the Political Reform Act audit program. In addition, the department administers several nontax programs, including collection of (1) child support, student loan, and motor vehicle registration delinquencies; and (2) court ordered payments. A three-member board—the Director of Finance, the Chair of the State Board of Equalization, and the State Controller—oversees the department. A board-appointed executive officer is charged with administering the day-to-day operations.

The *1999-00 Governor's Budget* proposes $378 million for support of the department, including $354 million from the General Fund. Both the total budget and General Fund support for the department are approximately 3 percent decreases from current-year expenditures. This decrease is mainly the net effect of: (1) a budget proposal to suspend the business tax reporting mandate resulting in a decrease of $16.3 million, (2) a $5 million reduction in the bank and corporation tax program area, and (3) a $10 million increase in the personal income tax program area.

Augmentations Not Justified

We recommend the Legislature delete the proposed augmentations totaling $8.2 million and 73.2 personnel-years (PYs) from various funds for support of the Franchise Tax Board because these augmentations have not been justified. Reduce various items by a total of $8,242,000 ($8,056,000 General Fund) and 73.2 PYs.

The Governor's budget proposes three augmentations totaling $8.2 million for the department as summarized in Figure 1 (see next page). As discussed below, we recommend the Legislature delete the additional funds and associated new positions.

Figure 1

Franchise Tax Board Proposed Augmentations

1999-00
(In Thousands)

	Funding Source					
Description	General Fund	Reimburse-ments	Motor Vehicle Account	License Fee Account	Court Fund	Totals
Limited liability companies	$1,792	—	—	—	—	**$1,792**
Audit and collection activities	3,350	—	—	—	—	**3,350**
Merit salary adjustment	2,914	$113	$25	$41	$7	**3,100**
Totals	**$8,056**	**$113**	**$25**	**$41**	**$7**	**$8,242**

Limited Liability Companies. The budget proposes $1.8 million and 18.1 PYs to address workload related to limited liability companies. At the time this *Analysis* was prepared, the department and administration had provided no information on this augmentation. The only information available was the descriptions of the augmentation contained in the Governor's budget document and summary which indicated that this augmentation would result in increased tax revenues in 2000-01. Because this augmentation has not been justified, we recommend the Legislature delete the funds and personnel.

Audit and Collections. The budget also proposes $3.4 million and 55.1 PYs to increase audit and collection activities. At the time this *Analysis* was prepared, the department and administration had not provided justification for this augmentation. The only information available was the descriptions of the augmentation contained in the Governor's budget document and summary which indicates that this augmentation would result in increased tax revenue collections in the budget year. Lacking any information, we recommend deletion of the augmentation.

Merit Salary Adjustments. The Governor's budget includes $3.1 million ($2.9 million General Fund) to fund merit salary increases provided by the department to employees. (It is our understanding that no other department received an augmentation for employee merit salary adjustments.) In the past, the department has submitted budget change proposals for merit salary adjustments provided to employees. This year, however, the budget-year augmentation was simply added as a *baseline* *adjustment*, without either justifying or identifying the increase. Under the circumstances, we recommend that the Legislature delete the $3.1 million added to the budget for merit salary adjustments. (Reduce various items by $3,100,000, [$2,914,000 General Fund].)

Performance Audit

We recommend the department provide the Legislature with detailed information on why tax program reductions recommended by a performance audit have not been implemented. Pending receipt and review of this information, we withhold recommendation on $7.4 million in the department's budget.

In 1998, the board contracted with an independent auditor to conduct a performance audit of the department. The preliminary audit results were presented to the board in October 1998. The board requested the auditor review specific recommendations, and provide further analysis and detail. The auditor presented the final report in December 1998. The report found several areas in the department's operations that need improvement and made recommendations accordingly. The auditor suggested a five-year action plan to implement the recommended changes. The auditor classified the recommendations as high, medium, or low priority based on several factors. We highlight the four high-priority recommendations that affect the department's tax programs. The total savings associated with these reductions, based on the audit's five-year plan, is an estimated $37 million. Assuming that savings would be realized equally over all five years, the first year savings would total $7.4 million, as shown in Figure 2 (see next page).

A brief discussion of the recommended reductions follows.

Span of Control and Management Structure. The auditor reviewed the department's span of control and management structure. The auditor found that the *layers* of management are appropriate but, based on several factors, the *span of control* is too low (that is, each manager supervises, on average, too few staff). The auditor concluded that the targeted span of control ratio for the department should be one manager for every ten staff (1:10). For 1997-98, the department's average span of control was one manager for every 9.1 staff. Thus, according to the audit, a slight increase in the span of control is warranted. Specifically, the auditor recommended the department reduce filled management positions by 10 percent (55 positions) and eliminate 60 vacant positions to achieve an overall average span of control ratio of 1:10.

Figure 2

High Priority Recommendations Affecting Tax Programs

(In Thousands)

Description	Reductions	
	Budget-Year[a]	Five Year Total Reduction
Span of control	$1,640	$8,198
Filing system assessment and reductions	513	2,564
Information technology positions	4,587	22,935
Customer service	643	3,215
Totals	**$7,383**	**$36,912**

a LAO estimate based on equal phase in of total reduction recommended by independent auditor.

Filing System Assessment and Reductions. The department processes over 13 million personal income tax returns annually. Currently, the majority (91 percent) of those returns are filed using traditional methods—paper returns manually prepared and mailed to the department. However, the department has seen dramatic increases in both electronic filing and telephone filing over the past three years. These filing methods are much less staff intensive than traditional methods and as such should result in reductions in department staff and resource levels. Based on estimated growth in both electronic and telephone filing, the auditor estimated that the department will be able to reduce a total of 89 filing staff and realize budget savings totaling $2.6 million over five years. The auditor further recommended that these reductions be phased in to coordinate with the increases in alternative method filing. Although the department concluded in its response to the audit that increased alternative filing will result in a reduction totaling 72.4 PYs and $2.1 million over the next five years, no reduction is included in the Governor's budget.

Information Technology Positions. The auditor conducted an analysis of the department's information technology personnel and concluded, based on several factors, that the department should reduce a total of 417 PYs over the next five years. According to the auditor, the department currently has 894 information technology personnel. Accepting the auditor's recommendation would result in a 46 percent reduction in information technology staff.

Customer Service. The auditor made several recommendations that affect the department's numerous customer service functions. However, only two recommendations had any savings associated with them. They are to:

- Discontinue mailing tax booklets to filers who use either a tax preparer or automated software to file the previous year's taxes.
- Realize budget savings resulting from elimination of the Employee Confirmation Report.

The auditor estimated five-year savings of $3.2 million from these actions.

Given the potential for improving the department's operations and the associated savings, we believe the Legislature should be given the opportunity to consider the suggested changes. Consequently, we recommend the department provide detailed information on why reductions recommended by the performance audit have not been implemented. Pending receipt of this information, we withhold recommendation on $7.4 million.

Integrated Nonfiler Compliance Project

We withhold recommendation on the $6.9 million General Fund request for the Integrated Nonfiler Compliance project. The project has not yet been approved by the Department of Information Technology.

The Governor's budget includes a $6.9 million General Fund augmentation for the department to redesign and begin implementation of the Integrated Nonfiler Compliance project. The current nonfiler program consists of a variety of automated and manual processes to achieve tax filing compliance from individuals and corporations not currently filing returns. The program currently includes 47.5 PYs and $3.1 million.

The department received a current-year augmentation totaling $2.7 million and 28.5 PYs to begin system redesign and the procurement for a new system. It is our understanding that the department is still in the design stage. In addition, the required feasibility study report (FSR) for the new system has not been approved by the Department of Information Technology. The department is not permitted to continue with the project unless it receives all necessary approvals. Consequently, we withhold recommendation pending approval by the Department of Information Technology and review of the approved FSR. Presumably the approved FSR will be available prior to budget hearings.

Business Tax Reporting Mandate

If the Legislature determines that suspending the business tax reporting mandate is appropriate, then we recommend that the Legislature also delete the positions associated with program workload. The department should identify these positions prior to budget hearings.

Pursuant to Chapter 1490, Statutes of 1984 (AB 3230, Hannigan), every city in California which assesses a business tax and maintains a computerized record keeping system is required to annually furnish specific information to the department. The department then uses this information to identify self-employed individuals for tax enforcement purposes. Cities that maintain a computerized system may file a claim to have certain costs—administrative and operational—associated with providing the data to the department reimbursed by the state.

The administration is proposing to suspend the tax reporting mandate and, therefore, eliminate the state's financial responsibility to the cities. Accordingly, the Governor's budget shows a decrease of $16.3 million for the program. However, the budget does not include a corresponding decrease in positions associated with this program.

This is the same proposal that has been submitted to the Legislature in recent budget bills. In each instance the Legislature has denied the proposal and funded the program. However, if the Legislature determines that the mandate should be repealed or suspended at this time, we would recommend that the Legislature also delete the positions associated with program workload. The department should identify these positions prior to budget hearings.

Unnecessary Budget Control Language

We recommend that the Legislature delete proposed budget language that would add administrative controls over the Franchise Tax Board. (Delete Provision 1 under Item 1730-001-0001.)

The budget bill includes language that would require Department of Finance (DOF) approval before the board could take the following administrative actions :

- Any reduction of expenditures or redirection of either funding or personnel from tax return processing, auditing, and collecting taxes owed. The DOF could not approve any such proposal before 30-day notification is provided to the Chair of the Joint Legislative Budget Committee.

- Any transfer of positions between organizational units as assigned in the *1999-00 Governor's Budget* and the *1999-00 Salaries and Wages Supplement* as revised by legislative budget action.

There is no explanation of the need for this language in the Governor's budget document.

To our knowledge all departments are required to implement the budget as approved by the Legislature and signed by the Governor. Various control sections in the annual budget act give the administration flexibility in implementing various programs throughout the year. For example, Control Section 26.00 provides for intraschedule transfers where necessary for the efficient and cost-effective implementation of the budget. The control section establishes specific parameters within which the administration can take these actions. We are not aware of any reasons to add additional administrative controls solely for the Franchise Tax Board. Lacking any such information, we recommend that the Legislature delete the proposed budget language. (Delete Provision 1 under Item 1730-001-0001.)

DEPARTMENT OF INFORMATION TECHNOLOGY (0505)

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

The DOIT was created by Chapter 508, Statutes of 1995 (SB 1, Alquist), in response to difficulties the state experienced in attempting to successfully deploy IT projects. The provisions of Chapter 508 related to DOIT will expire on July 1, 2000, and be repealed as of January 1, 2001, unless a new statute deletes or extends the sunset dates. We discuss this in more detail below.

The budget proposes $8.3 million ($7.6 million from the General Fund and $750,000 from reimbursements) for support of the department's operations in 1999-00, a decrease of $172,000, or 2 percent, from estimated current-year expenditures. The budget proposes 37.1 personnel-years for the department in the budget year, which is the same level as the current year.

Expiration of DOIT Allows Opportunity For Legislature to Consider Changes

The statutory provisions that created the Department of Information Technology in 1995 are set to expire on July 1, 2000. We believe that the Legislature should enact legislation to extend the life of the department and should consider a number of issues that could improve the operations of the department and state information technology generally.

Background. In 1995, the Legislature enacted major reform legislation relating to the planning, implementation, and oversight of the state's IT activities. This legislation—Chapter 508—was the result of several legislative hearings and various reports by our office, the Bureau of State Audits, and the Governor's Task Force on Government Technology and Procurement. The Legislature determined that major reform was necessary in order to address multiple serious problems affecting the state's IT activities. California state government spends more than $2 billion annually on these 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 IT in a cost-effective manner, and improve the Legislature's confidence in major IT initiatives. Figure 1 shows the major responsibilities assigned to DOIT by Chapter 508.

Figure 1

Department of Information Technology Major Responsibilities Under Chapter 508, Statutes of 1995 (SB 1, Alquist)

- ✔ Oversee the management of information technology in state agencies, with the 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 of local governments, including local school systems, private companies that provide services to state agencies, and federal government.

Sunset Provides Opportunity for Legislature to Reexamine State IT and DOIT. As indicated above, the provisions of Chapter 508 related to DOIT will sunset at the end of 1999-00. Thus, the Legislature will need to consider during the next year whether it wishes to extend the life of DOIT and what changes it may wish to make to its statutory mission and operations.

In our view, DOIT has added value to the state's IT program. However, we believe that it has not met all of the Legislature's expectations, as evidenced by the fact that the state continues to have difficulty implementing major IT projects. Thus, we think that the DOIT statute can be strengthened. Below we outline several issues for the Legislature to review as it considers the future of DOIT and IT in state government.

Is a State IT Agency Needed? Given the level of state expenditures for IT and the general importance of IT to state government, we believe that a central planning and oversight agency for IT continues to be needed. The major responsibilities outlined in Figure 1—oversight, information sharing, avoidance of duplication, policy development, and planning—are all vital. Thus, we recommend that the Legislature extend the life of DOIT.

Should DOIT Continue to Report to the Governor? Currently, DOIT is an independent state department that reports directly to the Governor rather than to a cabinet-level agency. Because DOIT has responsibility for oversight of IT in state departments across several different agencies, we believe that independence from a particular agency is important and necessary. However, we believe that it will be important for the Governor's Office to actively support DOIT and its director—the Chief Information Officer (CIO)—in order to ensure that DOIT can provide meaningful oversight and increase the chances of success of IT projects. In order to accomplish this, the Legislature may wish to consider elevating DOIT by giving the CIO cabinet-level status.

Should DOIT Be Given Additional Responsibilities? The Legislature will need to decide whether DOIT should have additional responsibilities for the oversight and management of state IT beyond those contained in Chapter 508. In our view, there are several areas that the Legislature should consider, including:

- Moving responsibility for IT procurement from the Department of General Services (DGS) to DOIT.
- Moving responsibility for state telecommunications policy and operations from DGS to DOIT.

- Having the state's major data centers report to DOIT rather than their current agency secretaries.
- Giving the CIO a formal or informal role in the selection of IT directors in individual departments.

We believe that there are good reasons both for and against providing these additional responsibilities to DOIT which need further study and analysis before decisions are made.

Should the Legislature Clarify the Role of DOIT? The DOIT took the place of the Department of Finance's (DOF's) Office of Information Technology. Chapter 508 limited the role of DOF to the approval of the expenditure of funds for IT projects. The DOF established the Technology Investment Review Unit (TIRU) to fulfill this role. In discussions with a number of state agencies, however, we have found significant confusion about the roles and responsibilities of DOIT versus TIRU. In order to maximize the benefit of each organization, the Legislature may wish to clarify these responsibilities in legislation.

Should DOIT Be Given Additional Resources? In our view, DOIT has never been adequately staffed to fully carry out its mission. If the Legislature wishes to extend DOIT with the same or additional responsibilities, we believe it must be willing to provide additional resources to the department, especially staffing, in order to maximize its potential benefit to state government.

Set Proper Expectations. If the Legislature ultimately decides to extend DOIT with the same or additional responsibilities, we believe that it will continue to be important that the Legislature set realistic expectations. Although we believe that the state of IT in California state government can be improved upon (we have outlined a number of improvements in several reports in recent years), some problems in the development and implementation of IT projects are likely to continue given the rapid pace of technological change and the ever-evolving needs of state government agencies to perform their activities.

What's the Status of the State's Year 2000 Correction Efforts?

We recommend that the Department of Information Technology provide the Legislature with a detailed status report on the state's Year 2000 correction efforts prior to budget hearings.

Background. Since its creation, DOIT has placed a priority on working with state departments to ensure that changes are made to the state's computer systems to accommodate the year 2000, or Y2K, change (these efforts are often referred to as "remediation"). The DOIT has produced numerous guides and documents for state departments on Y2K remediation and required departments to report periodically on their progress. In addition, the Governor issued an executive order in 1997 requiring all state departments to complete their Y2K correction efforts by December 31, 1998.

Funding for Remediation. During the last two years, the Legislature has appropriated about $100 million to state departments for Y2K remediation activities and departments have redirected millions of dollars more for these activities. The *1997-98 Budget Act* provided $55 million for this purpose that was distributed by DOF following review and approval of DOIT. The *1998-99 Budget Act* provided $20 million in a separate set-aside for distribution by DOF, as well as about $20 million more that was appropriated directly to individual departments for remediation. At the time this analysis was prepared, it was not clear how much of the $20 million set-aside had actually been distributed, although DOF advised that requests for funds from state departments will likely exceed the amounts available.

Budget Does Not Propose Additional Funds. The budget does not propose to set aside any funds in a separate budget bill item for 1999-00 for Y2K remediation, as it has been done for the past two years, and proposes few additional appropriations in individual departmental budgets. According to DOF, departments have been encouraged to complete all Y2K remediation this year, since the century change will actually occur during the budget year.

Budget Indicates That Evaluation of Situation Is Underway. The *1999-00 Governor's Budget Summary* indicates that the new administration will appoint a task force to immediately evaluate the state's most critical service delivery areas with respect to Y2K corrections. At the time this analysis was prepared, it was not clear whether the task force had been appointed.

The summary indicates that, should the evaluation uncover significant critical activities that need to be undertaken, the administration will recommend actions necessary to minimize the risk of failure and insure appropriate contingency plans are in place. It indicates that the administration may request additional funding in the spring.

Limited Up-to-Date Information. It is not clear how many state departments met the requirements of the 1997 executive order to complete Y2K remediation efforts by the end of 1998. This is because there is limited information available about the current status of the state's efforts. The last quarterly status report from DOIT was submitted in October 1998. In addition, the new administration has indicated that it is still completing its own assessment of the situation.

Among the findings of the October 1998 report:

- 51 percent of the state's most critical IT systems have either been remediated or do not require remediation.
- About half of the most critical systems have completed remediation, but some critical systems will not meet the December 1998 deadline.
- State agencies were beginning the process of evaluating the potential Y2K impact on those embedded systems within state government that control building access, security systems, facility management, telecommunications, and water and power services.

Audit Pointed Out Other Problems. In August 1998, the Bureau of State Audits (BSA) released a review of the state's readiness to deliver critical services at the change of the century. The audit found:

- Efforts to fix almost 700 of the state's most critical computer projects are not progressing as rapidly as reported, and some projects declared complete are not.
- Many critical systems have not been tested to determine if they are Y2K ready and time allotted for project testing is far less than IT industry norms.
- Agencies sharing data with other computer systems have not taken the steps necessary to protect against failures caused by uncorrected Y2K problems in other systems.
- Managers at most agencies have yet to develop tangible business-continuation plans in the event of Y2K-caused delays or failures.

The BSA recommended the Governor's Office ensure that all state agencies: (1) provide DOIT with accurate information on the status of the Y2K remediation efforts, (2) thoroughly test the remediation for each critical project, (3) protect their systems from missing or corrupted data supplied by external parties, and (4) establish business-continuation plans for core state business processes. The BSA recommended that DOIT:

(1) continue to collect and analyze information state agencies provide on their overall progress, (2) continue to collect information from agencies on the extent to which their data-exchange partners are Y2K ready, and (3) require agencies to indicate whether they have plans that ensure continuation of core business functions if the critical computer systems supporting those functions fail to work or are delayed because of Y2K problems.

In its response to the audit, DOIT stated that the findings and conclusions had substantial merit.

What Should the Legislature Do? Given the importance of IT to the operations of state government, we continue to believe that it is essential that state agencies make Y2K remediation their first IT priority, especially for those systems that are critical to the central missions of the agencies. Oversight by the Legislature continues to be necessary. At this time, however, there is limited information available directly from the administration about the current state of the situation. For this reason, we recommend that DOIT provide the Legislature with a detailed status report prior to budget hearings.

Department Failed to Provide Study of Data Centers

***The Department of Information Technology failed to complete a study on siting and configuration of the state's data centers as directed in the* Supplemental Report of the 1998-99 Budget Act.**

Background. One of the original tasks assigned to DOIT in Chapter 508 was to undertake preliminary assessment of the feasibility of consolidating the state's IT activities. In 1996, DOIT contracted for a study of the feasibility of consolidating the state's two main data centers, the HWDC and the Stephen P. Teale Data Center (TDC). In July 1997, DOIT released the report, which recommended consolidation and identified modest savings resulting from consolidation. However, the report recommended that no actions be taken toward consolidation until the state had completed all remediation activities related to the Y2K change.

1998 Budget Action. Last year, the administration requested funding to purchase one of the leased buildings that houses HWDC. The Legislature rejected this request in part because of concerns about the lack of an overarching policy guiding the future of the states two main data centers and the long-term plans, if any, for consolidation. The Legislature directed DOIT, in supplemental report language, to develop a data center siting and configuration plan by January 1, 1999, including a schedule and budget for siting and configuration of the state's data centers. In addition, the development of the plan by DOIT was a condition of the Joint Legislative Budget Committee's concurrence in an earlier proposal to lease a new facility for the TDC. During the budget process last year, DOIT agreed to prepare the plan.

Report Not Provided. In the fall of 1998, however, DOIT advised legislative staff that it would not be doing the study and that the issue of data center consolidation, siting, and configuration would be left for the new administration. This occurred despite the fact that the department assured the Legislature during budget hearings that it would complete the study.

The *1999-00 Governor's Budget* again proposes funding to purchase the HWDC facility (we discuss the proposed purchase in the "Capital Outlay" chapter of this *Analysis*). Thus, the Legislature is once again being asked to approve this acquisition without knowing what the long-term plans are for data center consolidation.

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 numerous state agencies. The cost of the center's operation is paid by these client agencies.

The budget proposes $85.4 million for support of the TDC in 1999-00 ($85.2 million from the TDC Revolving Fund and $162,000 in reimbursements). This is an increase of $1.7 million, or 2.2 percent, above estimated current-year expenditures. The primary reason for the increase is a requested augmentation of $2.2 million for costs related to the center's plan to relocate to a new facility during the budget year that is currently under construction. Specifically, the center plans to use the augmentation to simultaneously operate two facilities for approximately 90 days during the relocation because many of the TDC's customers require 24-hour a day, seven-day-a-week, availability of data processing services.

Budget Proposes to Transfer Large Portion of Fund Balance

We withhold recommendation on the proposed transfer of balances in the Teale Data Center Revolving Fund contained in Control Section 15.00, pending receipt and review of proposed trailer bill legislation designed to reduce potential cash-flow problems for the center and a revised breakdown of the amounts of money that would be returned to the General Fund and the other individual funds.

Background. The *1996-97 Budget Act* included funding for the Department of Finance (DOF) to conduct an audit of TDC's billing rate structure and financial controls. The audit was completed in mid-1998 and made a number of policy and technical findings and recommended some changes in TDC operations. Among them were findings that some of TDC's billing rates to its customers had been higher than the center's actual costs. The audit recommended that rates for some services be reduced.

Budget Proposes Substantial Reduction in Fund Balance. As a consequence of the audit findings, the budget proposes to return moneys collected from clients which exceeded the center's costs. Specifically, the administration proposes budget bill Control Section 15.00, which would transfer from the TDC Revolving Fund to the General Fund and other funds an amount determined by DOF to be in excess of a sufficient balance in the fund. The Governor's budget assumes that the fund will have a balance of $26.4 million at the end of the current year, and it proposes to transfer $22.7 million from the balance in the budget year. This amount includes $11.3 million that would be returned to the General Fund and $11.4 million that would be returned to various special funds.

Analyst's Concerns. We concur with the administration that TDC's billing rates should be reduced so that they cover only the center's actual costs and that efforts should be made to reimburse those funds that have been overcharged. However, we are concerned that the proposal may leave TDC with inadequate resources to meet its regular operating obligations.

The proposed transfer would leave the fund with a balance of about $5 million at the end of the budget year. We generally believe that departments that are supported by special funds should have reserves equal to about one to two months worth of their annual expenditures. In the case of TDC, this would mean a fund balance in the neighborhood of $7 million to $14 million, or substantially more than proposed.

We believe that this is particularly critical for TDC because many of its state agency clients have not always paid their bills in a timely fashion. Without a sufficient reserve, TDC could experience cash-flow problems that would impede its operations.

The DOF indicates that it is sensitive to the center's potential cash-flow difficulties and will seek budget trailer bill legislation to ensure that TDC is able to collect from state agencies in a more timely manner so that it can eliminate potential cash-flow problems. At the time this analysis was prepared, however, the legislation had not yet been developed. In addition, TDC and DOF indicate that the amounts of the proposed transfers to the General Fund and the other specific funds may change following further analysis of the overcharges.

For these reasons, we withhold recommendation on the TDC budget and budget bill Control Section 15.00, pending receipt of a proposed budget trailer bill language and a revised breakdown of the specific amounts proposed for return to the General Fund and other funds.

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 fully paid by its clients.

The budget proposes $250 million for support of the data center in 1999-00, which is an increase of $11 million, or 4.6 percent, above estimated current-year expenditures. The budget includes a number of increases for workload, the largest of which is a request for $15 million for additional data processing and storage capability and equipment. It also includes a number of decreases for completion of various aspects of certain large information technology projects.

Projects at Various Stages; Additional Requests for Funding Yet to Come

The Health and Welfare Data Center continues to develop several major social services-related information technology projects. The projects are at various stages of implementation and the budget proposes several changes to expenditures for the projects. However, it is likely that the Legislature will be asked to provide a substantial increase in expenditures beyond the amounts requested in the Governor's budget, presumably through the transmittal of budget amendment letters.

In 1995, the Department of Social Services (DSS) transferred to HWDC responsibility for three of the state's largest information technology projects. The projects, which were to automate welfare, child welfare services, and child support, were transferred due to the difficulties DSS was experiencing in developing the projects. Since that time, HWDC has been given responsibility for developing several other social services-related projects.

The projects are at various stages of implementation and the budget requests a variety of changes in HWDC's expenditure authority, as well as changes in expenditure authority in the DSS, which provides funding to HWDC for the projects. In this section, we describe the status of the projects and the requested changes in HWDC's budget. We note that, given the point in the development process of these projects, the Legislature is likely to see a number of requested changes to proposed budget-year expenditures, presumably through Department of Finance budget amendment letters.

Statewide Automated Welfare System (SAWS)

Four Consortia. The purpose of SAWS is to provide improved and uniform information technology capability to county welfare operations. The system is being delivered through a state partnership with the counties, which have chosen to be in one of four consortia. Figure 1 shows the four consortia, the participating counties, and the current status of each.

As the figure shows, the budget proposes little change in HWDC's expenditure authority for the budget year for the four consortia. However, given the status of the projects, it is likely that the administration will submit budget amendment letter requests to appropriate more money for them in the *1999-00 Budget Act*. For example, the administration has already provided information to the Legislature that there will be an increase of $20 million in the contract for Los Angeles Eligibility Automated Determination, Evaluation, and Reporting (LEADER) System.

The SAWS Consortium Planning and Management. Because of delays and extensions in the planning schedules for two of the consortia (Welfare Client Data System [WCDS] and Consortium IV [C-IV]), the budget proposes to continue HWDC's existing planning and management program for SAWS in the budget year. The budget requests no change in HWDC's spending authority, however.

The SAWS Technical Architecture (SAWS-TA). In addition to the four consortia, HWDC is responsible for SAWS-TA which will (1) enable the exchange of data among the four consortia for eligibility, anti-fraud, and case management purposes; (2) provide an interface for the consortia with other state automation systems; and (3) connect the consortia and state agencies to meet state and federal reporting requirements. The HWDC budget proposes a reduction of $1.3 million for SAWS-TA in budget year. However, planning documents for SAWS-TA are still under review within the administration, and the final planning documents could result in modifications to the budget-year request.

Figure 1

Statewide Automated Welfare System (SAWS) Consortia

	Status	Proposed Budget Change
Interim SAWS (ISAWS)		
35 counties: Alpine, Amador, Butte, Calaveras, Colusa, Del Norte, El Dorado, Glenn, Humboldt, Imperial, Inyo, Kern, Kings, Lake, Lassen, Madera, Marin, Mariposa, Mendocino, Modoc, Mono, Monterey, Napa, Nevada, Plumas, San Benito, San Joaquin, Shasta, Sierra, Siskiyou, Sutter, Tehama, Trinity, Tuolumne, Yuba	Working in all 35 counties	-$3.8 million
Los Angeles Eligibility Automated Determination, Evaluation, and Reporting (LEADER) System		
1 county: Los Angeles	Pilot testing; countywide implementation in 1999-00	None[a]
Welfare Client Data System (WCDS)		
18 counties: Alameda, Contra Costa, Fresno, Orange, Placer, Sacramento, San Diego, San Francisco, San Luis Obispo, San Mateo, Santa Barbara, Santa Clara, Santa Cruz, Solano, Sonoma, Tulare, Ventura, Yolo	Implementation to begin in February 1999	None[a]
Consortium IV (C-IV)		
4 counties: Merced, Riverside, San Bernardino, Stanislaus	Implementation to begin in September 1999	None[a]

[a] Given current status of contract development for projects, budget adjustments likely to be requested prior to enactment of *1999-00 Budget Act* (for LEADER and WCDS) or during 1999-00 after enactment of budget act (for C-IV).

California Work Opportunity and Responsibility to Kids (CalWORKs) Reprogramming. Recent changes in state and federal welfare laws will necessitate system changes, especially for LEADER and Interim SAWS (ISAWS). The budget proposes to reduce expenditure authority for HWDC by $5.5 million in 1999-00 to reflect work completed on LEADER. However, the ISAWS consortium is still identifying and assessing the technological alternatives. Thus, additional costs for ISAWS reprogramming have yet to be identified, and funding may be requested for the budget year.

Child Welfare Services/ Case Management System (CWS/CMS)

The CWS/CMS provides a statewide database, case management tools, and reporting system for the state's Child Welfare Services program. The project began at DSS in 1990. The project has completed development and the system is in operation in all 58 counties. The project has now moved into the maintenance and operation (M&O) phase.

The budget requests an increase of $1.2 million for M&O services in the budget year due to caseload growth. This increase is the net effect of the center's assumption that M&O services will cost an extra $10.4 million, offset by $9.2 million in existing expenditures already in HWDC's budget for CWS/CMS infrastructure changes that will be completed in the current year. However, this amount is based on current contracts. Pending the outcome of negotiations for the new M&O contract, the requested amount could change, either through the budget letter amendment process or during the budget year through the section letter process.

Electronic Benefits Transfer

Electronic Benefits Transfer (EBT) is the electronic transfer of funds to welfare recipients. This includes food stamps and welfare cash benefits for the CalWORKs program. The system uses debit card technology and retailer terminals to automate benefit authorizations, delivery, redemption, and financial settlement, thereby eliminating paperwork. The HWDC is responsible for planning, developing, and implementing EBT technology statewide for Food Stamps and CalWORKs.

Federal law requires that all states implement EBT for Food Stamps by October 2002. The planning phase for the project is scheduled for completion at the end of the current year, but HWDC advises that it may be delayed for several months into 1999-00. The budget requests an increase in HWDC spending authority of $1.6 million to begin implementation in 1999-00.

Chapter 270, Statues of 1997 (AB 1542, Ducheny), required that the state certify *one or more* vendors by July 1, 1998, as eligible to contract with counties to develop and implement an EBT system. The HWDC, working with DSS and the counties, developed a strategy in which the state would contract with and certify EBT processors. The counties, grouped as consortia, would then select and contract with one or more processors to implement EBT in the counties.

In response to concerns expressed by the counties, HWDC is changing its strategy to provide that the state contract with a *single* vendor to implement an EBT system statewide. Chapter 329, Statutes 1998 (AB 2779, Aroner), made the changes in law that permit this new approach.

State Fingerprint Imaging System (SFIS)

The SFIS is a system which will automate the collection, interpretation, and storage of fingerprints for persons applying for public benefits. The purpose of the system is to reduce welfare and food stamp fraud. The HWDC originally intended to award a contract for the system in late 1997, but a bid protest delayed execution of the contract into 1998. Before the contract could be executed, however, HWDC canceled the procurement in response to the Governor's March 1998 executive order requiring departments to rebid all state contracts that had not yet been executed. (The executive order was in response to a federal court ruling which found that provisions of state contract law related to participation goals for minority and women-owned businesses were unlawful.) The state had to rebid the contract in June 1998, and HWDC estimates that the contract will be awarded in March 1999, with statewide implementation competed by March 2000.

The budget requests increased expenditures for HWDC of $9.5 million for SFIS in the budget year. This request could change, however, based on the final contract award.

California Child Support Automation (CCSA) Project

The CCSA is the successor to the Statewide Automated Child Support System (SACSS). The SACSS, a federal and state-mandated computer system, was intended to provide a statewide automated child support enforcement tracking and monitoring capability through the offices of county district attorneys. Following several years of difficulty and the expenditure of more than $100 million, the state terminated its contract with the SACSS vendor and canceled the project in late 1997. As a consequence of failing to implement a statewide system as required by federal law, the state will incur federal fund penalties. The budget assumes that the state penalty in the current year will be $37.1 million and $52.8 million in the budget year. (We discuss the penalties in more detail in our analysis of DSS in the "Health and Social Services" chapter.)

A New Approach. The Legislature established the new approach for CCSA in last year's budget and in Chapter 329. Under the new approach, HWDC plans to deploy a Statewide Case Registry (SCR) and Statewide Distribution Unit (SDU) which will enable the transmission of data and child support monies across county lines in compliance with the recently enacted welfare reform laws.

The administration's original plan called for a consortia approach in which counties would chose one of seven automated case management systems to connect to the SCR and SDU. Chapter 329 amended the plan to allow HWDC to chose up to four systems for the consortia and specified that Los Angeles County's system be one of the four. In addition, the measure specified that the four systems must be compliant with the Year 2000 changes and meet certain federal requirements by April 1, 1999. Systems not found in compliance by June 1, 1999 would be excluded.

In November 1998, HWDC announced its selection of the four systems from which the counties could chose—the Los Angeles's ARS, San Francisco's CASES, Kern Couny's KIDZ, and Riverside County's STAR/KIDS.

Federal Approval Still Pending. Although all 58 counties have now chosen which system they plan to use, HWDC is still awaiting the federal government's approval of the state's new approach to develop four systems rather than a single statewide system. Federal approval will be crucial to determine how much of the costs of the system the federal government will pay.

Long-Term Strategy. Chapter 329 also required the administration to develop a long-term strategy for child support automation. Specifically, it required DSS to establish a steering committee comprised of representatives of DSS, HWDC, the Department of Information Technology, the California District Attorneys Association, the County Welfare Directors Association, child support advocates, Members of the Legislature, and the U.S. Department of Health and Human Services. The committee is to develop standards, goals, priorities, objectives, and an evaluation model to guide the department on a study and report regarding the best long-term solution for statewide automation, including whether another entity should be responsible for managing the CCSA project. The HWDC is contracting with a vendor for a Feasibility Study Report (FSR) for development of the long-term solution.

Budget Proposal. The budget proposes to reduce expenditures by $8.7 million in the budget year due primarily to completion of transitioning of counties from the SACSS system to other systems and elimination of SACSS' M&O costs. Given the rapid changes occurring in this project, the still-to-come response to the state's new approach from the federal government, the state of development of the SCR, SDU, and FSR for the long-term solution, it is likely that there will be changes in the requested amounts.

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 $99.2 million ($62.2 million from the General Fund) to support the activities of the State Controller in 1999-00. This amount is an increase of $1.9 million, or 1.9 percent greater than estimated current-year expenditures. This includes requested funding for the Controller's main budget bill item (Item 0840) and for two information technology projects within a newly created budget bill item (Item 0841) titled the State Controller's Statewide Information Technology Projects.

The Human Resources Management System

In the current year, the State Controller's Office began work on the Human Resources Management System prior to final review of a funding request by the Legislature. The budget proposes to continue the project in the budget year.

Background. The *1998-99 Budget Act* appropriated up to $1.2 million from the General Fund in Control Section 8.80 to the Controller and the Department of Personnel Administration (DPA) for development of a major new information technology project—the Statewide Human Resources Management System. The system would replace the state's existing payroll and personnel systems. The Controller's share of these funds included $240,000 to support four one-year limited term positions, and $653,000 to cover the costs of consultants.

The activities for the project in this first year were to include (1) approval of an alternative procurement approach, (2) development of a Request for Information to secure a pool of qualified vendors, (3) definition of business and technical requirements, and (4) development and release of a Request for Proposal to select a software solution. The entire project is scheduled to take five years to complete, with an estimated cost of $60 million.

Control Section 8.80 specified that the funds were to be allocated no sooner than 30 days after written notification to the Chairs of the Joint Legislative Budget Committee (JLBC), the Assembly Budget Committee, and Senate Budget and Fiscal Review Committee, including a mutually agreed upon justification explaining the need for the funds and positions, and identifying a project schedule and deliverables.

Work Started Prior to Control Section Approval. In August 1998, the Director of Finance wrote a letter to the chairs of the committees in response to the provisions of Section 8.80, and included a joint letter from the Controller and Director of DPA stating that the departments agreed to coordinate on the project. The Chair of the JLBC subsequently informed the Director that he did not concur with the Director's plan to release the funds and suggested that a revised submittal addressing a number of specific concerns would merit further legislative consideration.

The Department of Finance (DOF), Controller, and DPA subsequently submitted additional information to respond to concerns raised by the Chair of the JLBC. However, in January 1999, the DOF released the funds without submitting another letter to the Legislature pursuant to Section 8.80.

Our review indicates that the Controller's office began work on the project at the beginning of the current year, well before the request for release of funds was made pursuant to Section 8.80. Specifically, the Controller redirected resources and entered into contracts with outside consultants as of July, and hired new positions in August. The Controller's Office indicates that by starting immediately, it has been able to remain on its projected time schedule and perform a number of necessary procurement functions.

We have reviewed the Controller's office budget request for the Human Resources Management System. Despite our concerns that the Controller's office began spending money for this project in the current year prior to authorization as prescribed in Control Section 8.80, we believe that the request for funding in the budget year is reasonable.

DEPARTMENT OF GENERAL SERVICES (1760)

The Department of General Services (DGS) is responsible for providing a broad range of support services to state departments and performing management and oversight activities related to these services. It provides these services through three programs: statewide support, building regulation, and real estate services.

The Governor's budget proposes total expenditures of $613 million from various funds (including $50.8 million from the General Fund) to support the activities of DGS in 1999-00. This is $2.6 million, or less than 1 percent, below estimated current-year expenditures.

Statewide Support Services. Expenditures for statewide support services are $340 million in the budget year, representing an increase of $924,000, or less than 1 percent, over estimated current-year expenditures. The amount includes several small increases and reductions to programs. The largest request is $4.9 million for local assistance proposed to upgrade the 9-1-1 telephone system switching equipment in the current and budget years.

Building Regulation Services and Real Estate Services. Proposed budget-year expenditures for these services are $265 million, or $3.9 million less than current-year levels. There are no major changes in the budget, but rather proposed continuation of augmentations made in the current year pursuant to budget act authority provided to the department.

Master Plan Needed for Public Safety Microwave Network

We recommend that the Legislature adopt supplemental report language directing the Department of General Services, in cooperation with other state and local agencies, to develop a master plan for the Public Safety Microwave Network. We further recommend that the Legislature not approve any additional funds for changes to the network until completion of the master plan.

Background. The Public Safety Microwave Network is a key communication system for public safety and other public agencies in California. It serves 36 state agencies, three federal agencies, and three counties. The five major users of the network, which represent over 95 percent of the network's use, are shown in Figure 1. The percentage of use made of the system by each is expressed in circuit-miles (that is, one circuit between two points one mile apart is one "circuit-mile").

Figure 1

Public Safety Microwave Network
Five Largest Users

Agency	Circuit-Miles	Percentage of Use[a]
California Highway Patrol	33,017	44%
Department of Transportation	18,881	25
Department of Forestry and Fire Protection	12,890	17
Office of Emergency Services	6,980	9
Department of Water Resources	3,476	5

[a] Percentage of the total use by these five largest users.

The initial state microwave system was created in 1953 to support what is now the Office of Emergency Services. Other agencies then began creating their own, sometimes overlapping, microwave systems. In 1978, the Legislature enacted legislation which established DGS as the central owner and manager of the entire network.

The 1994 Study Called for Conversion to Digital Technology. In 1994, the DGS undertook a study of the ability of the network to meet the needs of the users. Part of this study included an evaluation of the comparative merits of the existing analog system and a digital system. The report concluded that the system should be converted to digital technology because of its substantially greater capability and because of a decreasing availability of analog equipment. The study estimated the costs of analog-to-digital conversion as indicated in Figure 2 (see next page).

We have several concerns about the current direction the department is taking with regard to the network.

Overall Cost of Analog-to-Digital Conversion Understated. First, it appears that DGS has underestimated the cost of the analog-to-digital conversion, particularly the site improvement costs. Although the DGS is by law the owner and manager of the network, it owns and manages only the equipment, which is located on sites owned and managed by various "landlord" agencies. The California Highway Patrol (CHP), as an example, is landlord for 217 tower-and-vault facilities and the California Department of Forestry and Fire Protection (CDFFP) for 130.

Figure 2

Analog-to-Digital Conversion Costs For Public Safety Microwave Network

(In Millions)

One-Time Costs	
Equipment costs for conversion	$45
Analog conversion for 2 ghz radios	20
Site improvement costs	20
Recurring Costs	
Ongoing maintenance costs	$2
Network management costs	5

The *1995-96 Budget Act* appropriated $10 million for CDFFP to replace 22 towers and vaults with ones having the proper configuration and load-bearing capacity for a digital system. Bids for construction of towers funded by this appropriation were substantially higher than estimated, and it was not possible to construct 22 towers as planned. Subsequently, in 1997 the Legislature adopted supplemental report language directing that the 1995-96 appropriation be used to fund the 11 highest priority towers-and-vaults. These projects are currently being implemented. The Legislature also appropriated $9.1 million in the *1998-99 Budget Act* to replace another nine towers. Thus, to date, $19.1 million has been appropriated to replace only 20 towers.

Clearly the DGS estimate of $20 million for all site improvement costs, for all landlord agencies, was very low. The CDFFP currently estimates the future cost to upgrade its remaining towers and vaults to be $61 million. These estimates do not take into account the cost for upgrading the CHP's 217 facilities, as well as those owned by other state agencies.

This is clearly a significant capital outlay program, for which the Legislature has not been given a comprehensive master plan that identifies the total cost of the program, a schedule for completion, and addresses the issue of how that cost burden should be allocated among state agencies and others that utilize the network.

Allocation of Cost Is Questionable. Our second concern is that DGS has not addressed how the cost of the analog-to-digital conversion should be allocated among the users of the network, both state and nonstate. The CDFFP uses 17 percent of the network capacity compared to 44 percent by the CHP and 25 percent by the Department of Transportation (Caltrans). Current plans indicate CDFFP will bear a larger proportion of the cost of upgrading tower and vault facilities than may be warranted by its use of the network. Conversely, the CHP and Caltrans do not appear to be bearing a proportion of this cost commensurate with their use of the network. This is an important consideration because of the different funding sources these departments use. The CDFFP relies mostly on the General Fund for funding whereas Caltrans and the CHP have the State Transportation Fund as a resource.

Master Plan Is Needed. We believe that these issues need to be clarified in a comprehensive master plan. For this reason, we recommend that the Legislature direct DGS to complete such a plan in cooperation with the network landlords and user state agencies and, to the degree practical, nonstate agencies as well. Until such a master plan is complete, we recommend that the Legislature not fund additional changes to the network. The only projects what will be delayed as result of this recommendation are the tower and vault projects for CDFFP in this budget, and this delay will only be for one year. Since replacement of the 20 most critical CDFFP towers and vaults have already been funded and their replacements in progress, the towers and vaults proposed in the budget are not critical, and there will be no threat to the overall performance of the network during this one-year period while the master plan is being prepared.

The master plan should addresses the following issues:

- A confirmation that the microwave technology recommended by DGS in its 1994 report continues to be the preferred option, in light of the current state of the art in communications technology.
- A summary of the regulatory environment within which the system will operate, with specific emphasis on the impact of personal communication systems on the communications spectrum available to the network.
- A quantified summary of system usage by agency, both state and nonstate.

- A comprehensive estimate of all costs associated with the analog-to-digital conversion, including the cost of tower and vault replacements, renovations, and modifications.
- A recommendation for an equitable allocation of the cost of conversion among those agencies.
- A schedule for implementation of the plan.

This could be accomplished by adopting the following supplemental report language:

> The Department of General Services (DGS) shall develop a master plan for the Public Safety Microwave Network. In developing the plan, the department shall work with the network landlords and user state agencies and, to the degree practical, nonstate agencies. The plan shall include, but not be limited to, the following: (1) a reassessment and confirmation that the microwave technology recommended by DGS in its 1994 report continues to be the preferred option, in light of the current state of the art in communications technology; (2) a summary of the regulatory environment within which the system will operate, with specific emphasis on the impact of personal communication systems on the communications spectrum available to the network; (3) a quantified summary of system usage by agency (both state and nonstate agencies); (4) comprehensive estimates of all costs associated with the analog-to-digital conversion, including the cost of tower and vault replacements, renovations and modifications; (5) a recommendation for an allocation of the cost of conversion among those agencies; and (6) a schedule for implementation of the plan. The department shall submit the master plan to the relevant fiscal and policy committees of the Legislature by December 1, 1999.

Because of the need first to have a master plan, we have recommended deletion of a $5.3 million request for network towers and vaults for the CDFFP. This is discussed further under CDFFP's capital outlay write-up (please see Item 3540).

HOUSING AND COMMUNITY DEVELOPMENT (2240)

The mission of the Department of Housing and Community Development is to help promote and expand housing opportunities for all Californians. As part of this mission, the department is responsible for implementing and enforcing building standards. The department also administers a variety of housing finance, economic development, and rehabilitation programs. In addition, the department provides policy advice and statewide guidance on housing issues.

The budget proposes expenditures of $172 million for 1999-00. This is a 1.5 percent increase from estimated current-year expenditures. The proposed General Fund appropriation of $28.1 million is a 34 percent increase over the current year and accounts for 16 percent of the department's proposed funding. Federal funds account for $101.8 million, primarily for the Community Development Block Grant and Home Investment Partnership Act programs. A number of state special funds provide the remainder of the department's funding. The department has a proposed staffing level of 475 personnel-years.

Below, we provide an update on the administrative costs for the department's homeless grant program, review the Governor's proposals for new housing spending, and assess the workload of the mobilehome registration and titling program.

Update: Costs to Administer Homeless Grants Remain High But Improving

The Emergency Housing and Assistance Program (EHAP) is a grant program that provides funds to local governments and nonprofit organizations to support shelters and services for the homeless. As has been the case for the past several years, the budget proposes $2 million from the Housing Trust Fund to fund the local assistance grants. As we discussed in the *1998-99 Analysis* (see pages G-112 through G-114), the program's administrative costs for distributing the grants are extremely high. In an effort to lower these expenses, the 1998-99 budget reduced the EHAP administrative budget by $100,000 to $457,000. Although its costs have declined somewhat with this budget reduction, the department continues to spend nearly $4,000 to administer an average grant of less than $16,000.

In response to these concerns, the Legislature requested the department to report on its efforts to reduce costs and explore alternative delivery methods for the grants. In its preparation of the report, the department surveyed counties to determine their willingness to receive a direct allocation in place of the current grant process, similar to the one we proposed in last year's *Analysis.* About two-thirds of those responding supported this concept, with many counties emphasizing the possibility to integrate the EHAP funds with their other existing programs. Therefore, we continue to believe that such a system could greatly reduce administrative costs.

The department expressed some concerns with the direct allocation approach, however, and as an alternative outlined a number of steps it plans to take to further reduce administrative costs over the coming years within the existing program structure. If all of these measures yield their predicted savings, then the department proposes to reduce its current administrative costs by more than half by 2001-02.

Increase Effectiveness of New Housing Dollars

The budget proposes $10.5 million in new spending on housing programs and the Governor's Housing Task Force. We recommend that (1) $10 million be held in reserve and allocated by legislation that takes into account the Housing Task Force's recommendations and (2) $500,000 be available for expenses of the task force.

The Governor has proposed a Housing Task Force to develop and implement a plan to address California's lack of adequate affordable housing. To help achieve this end, the budget proposes $2.5 million for the task force's use—for both its planning work and implementation. (For a more detailed discussion of the task force's proposed agenda, see pages F-20 through F-28.)

In addition, the budget proposes $8 million in new General Fund spending for three department programs:

- $1 million for the self-help housing program (bringing total program funds to $2 million) to provide technical assistance grants to organizations which help families build their own homes.

- $2 million for the farmworker housing grant program to help fund the development of homes for low-income agricultural employees.
- $5 million to create a welfare-to-work housing grant program. Funds would be used to develop community housing that provides services typically needed by individuals moving from welfare assistance to self-sufficiency.

While we support the idea of a comprehensive study to address housing affordability issues, the administration has yet to provide many details regarding the task force's work. In addition, the administration's budget bill language authorizing the expenditure of the task force funds provides only minimal opportunity for legislative oversight. As written, any amount of the $2.5 million could be spent on administration and developing the plan with no further legislative approval. Moreover, *any funds to be spent on local assistance would only require notification* to various committee chairs 30 days prior to expending the funds.

Given that the task force will likely develop the administration's housing priorities for the coming years, the Legislature should have a greater opportunity to decide how the $2.5 million and any future funds will be spent. Furthermore, while each of the new budget augmentations have some merit on their own, it is unclear that these augmentations are the *best* use of limited state housing dollars or are the most appropriate areas for state intervention.

Accordingly, we recommend that $10 million in housing funds ($8 million from the proposed augmentations and $2 million of the $2.5 million designated for the task force) be held in reserve. These funds could then be allocated by legislation that takes into account the task force's recommendations. In this way, the proposed new housing funds could be strategically directed by the Legislature to those areas in which state funding can be used most effectively. We recommend that the remaining $500,000 be available for use by the task force to support its administrative expenses.

Effort to Reduce Mobilehome Title Backlog

We withhold recommendation on the approval of 25 permanent and 18 limited-term positions for the Mobilehome Registration and Titling Program, pending additional updates on ongoing workload and productivity levels.

The Mobilehome Registration and Titling Program processes the state registration of mobilehomes, manufactured housing, and similar forms of housing and provides their owners with title documents. The budget proposes the addition of 43 new positions (25 permanent and 18 limited-term) with an increased expenditure authority of $2.4 million. The request is an effort to address a long-standing backlog in the processing of titles, as well as account for an increase in ongoing workload. Currently, the department takes more than six months to process title registrations and changes.

In December of 1998, the department sought a deficiency authorization for these 43 positions in the current year. At that time, a number of concerns were raised regarding the request, including:

- ***Mix of Temporary and Permanent Positions.*** As a temporary problem, the backlog should be addressed with temporary staff. However, the department intended to use seven permanent positions, along with the 18 limited-term positions, for this purpose.
- ***Level of Ongoing Workload***. Until recently, the department did not track the level of weekly incoming transactions. Therefore, it was unknown whether workload from the past few months was an accurate reflection of the department's expected workload in the coming years.
- ***Level of Staff Productivity.*** The productivity assumptions of the department assumed only modest benefits from ongoing computer training. The department also did not account for expected increases in productivity resulting from (1) improved consistency between their forms and their computer system and (2) improved management practices.

Despite these concerns, the Legislature approved the deficiency request in order to have the department begin work immediately on eliminating the backlog.

Concerns Over Staffing Levels Remain. The department's current personnel request is based on the same assumptions as their original deficiency request. Therefore, the concerns remain over the appropriate level of permanent staffing for the program. In fact, additional data collected since the time of the deficiency authorization indicates that ongoing workload may be declining. However, with less than a year's worth of actual transactions, it is difficult to assess the department's permanent staffing needs. Consequently, we withhold recommendation on the department's request. Prior to budget hearings, the department should report on subsequent workload and productivity developments in order to provide a more accurate estimate of its staffing needs.

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 $67.2 million from various funds, including $50 million from the General Fund, for the agency in 1999-00. The total budget is $61.3 million, or 48 percent, less than estimated current-year expenditures. The reduction is due primarily to a reduction in spending for the removal of underground storage tanks and various one-time expenditures in the current year for local economic development programs.

Commission of the Californias

We recommend that the Legislature delete the request for $250,000 from the General Fund and two positions to augment existing resources for the Office of California-Mexico Affairs because the agency has not justified the request. (Reduce Item 2920-001-0001 by $250,000.)

The agency requests an augmentation of $250,000 from the General Fund and two positions for the Office of California-Mexico Affairs to dedicate additional resources to the Commission of the Californias. The agency indicates the additional funds would also be used to address border-related economic development issues.

The Office of California-Mexico Affairs provides a centralized office to deal with issues affecting the relationship between California and Mexico. It also provides information on policy issues and business opportunities to California firms working with Mexico. The office is involved in coordinating two conferences—the Border Governors' Conference and the Commission of the Californias. The Commission of the Californias, which has formally met only once since 1991, was established in 1964 to promote favorable economic, educational, and cultural relations with Baja California, Baja California Sur, and the rest of Mexico.

Currently, the Office of California-Mexico Affairs staff includes a director and a deputy director. This proposal would add two staff members to work exclusively on projects associated with the Commission of the Californias. The agency's request did not include any information on the need for two additional staff. It merely indicated that the proposed funding and staff would be used to "reinvigorate the Commission and work on the multiple economic development activities associated with the border region." Lacking any specific justification for this increase, we recommend that the Legislature delete the request.

Foreign Trade Offices

We withhold recommendation on the $5.8 million requested from the General Fund for the agency's foreign trade offices pending receipt of the reports the Legislature requested in 1998-99.

Through its International Trade and Investment Division, the agency oversees the activities of California's ten foreign trade offices. As shown in Figure 1, the budget includes $5.8 million from the General Fund for these offices in 1999-00.

For the past several years, the Legislature has been concerned about the cost-effectiveness of the agency's various foreign trade offices. As a result, in the *Supplemental Report of the 1998-99 Budget Act*, the Legislature directed the agency to submit several reports on the offices. These reports were due to the Legislature by January 1, 1999 and were to include a:

- Report on specified performance data for all the offices, such as the number of private sector inquiries, the number of businesses served and type of assistance provided, and a breakdown of office income and expenditures.
- Report on performance measures (established July 1, 1998) to evaluate the performance of all the offices. In addition, the Legislature directed the agency to (1) require all office directors to spend at least 75 percent of their time in the home country of their assigned office; (2) perform a cost-benefit analysis of each office to quantify its benefits; and (3) require office directors to possess prior international private sector experience with a major export industry, as well as in-depth knowledge of the California economy and trade affecting California.

Figure 1

**1999-00 Proposed Funding
Foreign Trade Offices
Item 2920-012-0001**

(In Thousands)

Location	1999-00 Budget
Taiwan	$317
Africa	422
Germany	584
Hong Kong	956
London	511
Mexico City	1,279
Japan	1,163
Shanghai	296
Calgary	143
Philippines	158
Total	**$5,829**

Also, by April 1, 1999, the agency is to report the performance and rank of each office to the Legislature.

At the time this analysis was written, the agency had not submitted the requested reports that were due to the Legislature by January 1, 1999. Consequently, we withhold recommendation on the $5.8 million requested from the General Fund for the agency's ten foreign trade offices pending receipt and review of these reports as well as the April 1, 1999 report.

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 $27.4 million for support of the department in 1999-00. The principal funding sources are:

- $6 million from the General Fund.
- $14.8 million from reimbursements from other state departments.
- $5.9 million from the Deferred Compensation Plan Fund.

The proposed expenditures for DPA support are about $2.8 million, or 9.4 percent, less than estimated current-year expenditures. This change includes reductions of (1) $3.3 million in reimbursements, largely because individual departments, rather than DPA, will hire consultants for "total quality management" under the Statewide Continuous Improvement Program; and (2) $0.3 million in benefits administration, pursuant to Chapter 602, Statutes of 1998 (SB 1416, Brulte), which exempted the Deferred Compensation Plan Fund from pro rata charges. These reductions are partially offset by proposed expenditure increases of about $0.8 million for DPA's involvement in developing a new payroll/personnel system, implementing a drug testing program pursuant to a collective bargaining agreement, and auditing the Savings Plus Program.

Replacement of Payroll/Personnel System

We recommend that the Legislature delete the request for $604,000 from the General Fund and six one-year limited-term positions for the Department of Personnel Administration (DPA) to participate in the State Controller's project to replace and upgrade the state's payroll/personnel system because DPA has not provided sufficient justification for the request. (Delete $604,000 from Item 8380-001-0001.)

The DPA requests $604,000 from the General Fund and six one-year limited-term positions for its involvement in the State Controller's project to replace and upgrade the state's payroll/personnel system. Although the six positions are requested for one year, DPA has indicated that the department intends to request continuation of the positions during the budget process for the 2000-01 budget. The proposal includes $338,000 for the six positions, $188,000 for consulting services, and $78,000 for operating expenses.

The DPA is one of several departments that will participate in the State Controller's project. The State Controller will form an advisory committee to provide business and operational input for the new system. This advisory committee will consist of representatives from the State Controller, DPA, the Public Employees' Retirement System, the State Personnel Board, the Department of Finance, the Department of Information Technology, and three unspecified departments–one large, one medium, and one small.

Current-Year Funding. Control Section 8.80 of the *1998-99 Budget Act* provided *up to* $1.2 million from the General Fund for the State Controller and DPA costs related to this project. These funds, however, were not available for expenditure until DPA and the State Controller submitted to the Department of Finance (DOF) a mutually agreed upon written justification explaining the need for the funds and position(s) and identifying a project schedule and deliverables in 1998-99. Allocation of the funds was not to occur sooner than 30 days after DOF notified specified legislative committees of the written justification. In a letter dated August 28, 1998, the Director of Finance submitted the required notifications. In response, the Chair of the Joint Legislative Budget Committee advised the Director that he did not concur with the proposal. The Chair advised the Director that a revised submittal reflecting a coordinated effort by the two departments and addressing specific concerns would merit legislative consideration. At the time this *Analysis* was written, a revised submittal had not been sent to the committees. Notwithstanding the Chair's response, the department recently allocated the funds to DPA and the State Controller. Furthermore, DPA staff have advised us that DPA dedicated two positions to the project and committed the Section 8.80 funds in *July*, prior to the Director of Finance's notification to the committees.

Need for Funds in the Budget Year Not Justified. The request for the budget year includes six one-year limited-term positions (including two positions subject to Section 8.80) and $188,000 for consultants. The DPA has not provided sufficient information or workload data to justify this request. As mentioned above, DPA is one of many departments that will participate in the development of the State Controller's project. The DPA has not substantiated the need to add more staff in order to participate along with the other departments. The DPA has simply described the anticipated participation and allocated six new positions to the project activities. Based on the DPA descriptions, however, it is not clear that these activities (such as meeting with the State Controller, reviewing DPA business practices, and reviewing vendor proposals) would require the six full-time staff requested.

Given the lack of data to substantiate additional staff, we recommend that the Legislature not approve the $604,000 General Fund request for the project.

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 DPA began negotiations in 1995 with the 21 bargaining units representing rank-and-file state employees (other than higher education) for new MOUs governing compensation and other terms and conditions of employment. These MOUs were to replace those that, for the most part, expired June 30, 1995. Under current law, the provisions of expired MOUs generally remain in effect pending adoption of replacement MOUs.

In 1998, DPA reached agreement with four of the 21 units and the Legislature approved these MOUs—California Correctional Peace Officers Association; California Department of Forestry Firefighters; Physicians, Dentists, and Podiatrists; and Health and Social Services/Professional. These MOUs are in effect until June 30, 1999. In addition, DPA has reached agreement with the California Highway Patrol, but at the time this *Analysis* was written the Legislature had not approved the MOU. This MOU, if approved, would also be in effect until June 30, 1999.

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.

In recognition of the statutory intent and the importance of these negotiations for the 1999-00 budget, we recommend that DPA report to the Legislature during budget hearings on the administration's collective bargaining proposals and the status of negotiations. Furthermore, in our analysis of "Augmentation for Employee Compensation" (Item 9800) in this section of the *Analysis*, we have recommended that the Legislature (1) require a minimum 30-day review period between the submittal of proposed MOUs to the Legislature and hearings on the proposals to ensure that their fiscal and policy implications are fully understood and (2) review the administration's MOU proposals at the budget hearings and adopt them in the budget act (or as amendments to the act if they are not available for review during budget hearings).

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 22,000, the department maintains a headquarters complex in Sacramento, 127 armories, 33 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 *1999-00 Governor's Budget* proposes expenditures of $460 million by the department. Of that sum, $433 million would come from the federal government, although only $34 million would be appropriated through the budget bill. The budget bill would also authorize the expenditure of $24 million from the state General Fund for the department, an increase of $1.2 million, or 5.3 percent, in the budget year. The balance of the request ($2.2 million) is from reimbursements and a special fund.

Redirect Armory Homeless Shelter Funds to Counties

We recommend that the $1 million provided to the department to use its armories as emergency winter homeless shelters be redirected to all counties as grants through the Emergency Housing Assistance Program. (Reduce Item 8940-001-0001 by $1 million and Increase Item 2240-101-0985 by $1 million.)

Each winter since 1987, National Guard armories have been used as emergency homeless shelters. The armories have been used because they (1) are already equipped to handle emergency shelter situations, (2) are available throughout the state, and (3) lie unused most nights. Yet, the program was intended as a temporary solution, and the Legislature has in the past expressed its interest in finding a more permanent solution to providing emergency homeless shelters. In 1997, the Legislature enacted a series of bills that extended the program for 26 armories through the winter of 1998-99. For the winter of 1997-98, limited funding was provided to the counties in which these armories are located. With this funding, counties paid the National Guard a nightly rent of $454 to use an armory as a shelter. For 1998-99, no supplemental funding was provided to the counties, but 14 armories are currently being used—with the counties paying the nightly rent from their own sources of funds. For additional background on this program, see our report *Sheltering the Homeless: Alternatives to the Armories* (December 1997).

The budget proposes to provide the Military Department with a $1 million appropriation to operate 26 armories in the winter of 1999-00. This would require legislation again extending the program's sunset date and would make the collection of rent from counties unnecessary. We agree with the administration's policy objective of continuing to make the armories available as emergency homeless shelters. In fact, the Military Department indicates that program improvements over the past two winters have eliminated most of the health, security, and soldier retention problems that the department reported in previous years.

However, we recommend two changes with regard to the $1 million appropriation. First, we recommend redirecting the funds from the department to the counties directly through the Emergency Housing Assistance Program (administered by the Department of Housing and Community Development). This method was used in 1997-98 and offers a major advantage over the administration's proposal. That is, counties can use the funds to provide homeless services through the best available means, including renting the armories. Alternative shelters, especially permanent ones, offer the possibility of providing more comprehensive social services to the homeless—such as health care, counseling, and job training—than can be provided at the armories. Second, we recommend allocating the $1 million among all counties, not just those authorized to use the armories, using the existing program allocation formula. The provision of emergency homeless services is a statewide problem—not one unique to the counties that continue to use the armories. Furthermore, those counties that have developed alternatives to the use of the armories in the past should not be penalized by their exclusion from funding for homeless services.

DEPARTMENT OF VETERANS AFFAIRS AND VETERANS' HOMES OF CALIFORNIA (8955-8966)

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 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, subventions to county veterans service offices, and direct educational assistance to qualifying dependents; and (3) operating veterans' homes in Yountville and Barstow, and next year also in Chula Vista, with several levels of medical care, rehabilitation services, and residential services.

The budget proposes total expenditures of $351 million for DVA in 1999-00. This is $9.4 million, or 2.8 percent, more than the estimated current-year expenditures. Total expenditures from the General Fund during the budget year would be $53 million, which is $8.4 million, or 19 percent, more than the estimated current-year level.

The increase in the budget reflects significant new staffing and funding for the activation of the new veterans' home in Chula Vista, with other DVA program spending remaining largely unchanged.

Size of Cal-Vet Portfolio Continues to Decline

The number of veterans holding Cal-Vet loans remains in steep decline despite efforts by administrators of the program to stabilize the size of the loan portfolio by cutting rates for borrowers and increasing its marketing efforts. As a result, program overhead costs are still growing. The Governor's budget calls for a review by the Secretary of Veterans Affairs regarding how the program can be restructured in order to allow surplus Cal-Vet funds to be used to meet other needs of veterans. We recommend enactment

of legislation in 1999 to phase out new loan activity by the year 2007 and to seek voter approval in 2000 to redirect surplus Cal-Vet funds to other programs that jointly benefit veterans and state taxpayers.

LAO Report Called for Changes. In our January 1998 report, *Rethinking the Cal-Vet Loan Program*, we outlined our proposal to phase out additional Cal-Vet lending activity by 2007 and to direct surplus Cal-Vet funds to programs that will benefit both aging war veterans and state taxpayers. We noted that far fewer veterans than in the past need home loans, but that these veterans have a growing need for medical care, nursing home care, Alzheimer's treatment, and other types of state assistance. We concluded that it was time to rethink the state's approach to veterans' assistance given the changes which have occurred in recent times.

We based our recommendations on the decline in veteran participation in the program, as evidenced by the fact that the number of loans in the Cal-Vet portfolio as of June 30, 1997, was less than a third of the number at the start of the 1990s. We noted this was due to the aging of the veterans population and their exit from the single-family housing market, federal law restrictions which will by 2007 further shrink the pool of veterans eligible for Cal-Vet loans, and the availability of loans for veterans through the private sector and other governmental programs.

As a result of the decline in the size of the loan portfolio, the overhead cost of servicing each Cal-Vet loan had been growing. We also called attention to recurring financial losses stemming from past mismanagement of the program. The mismanagement had reduced the state's equity in the Cal-Vet operating fund (defined as the value of all program assets after all liabilities have been subtracted) by about $200 million or 44 percent of its value over 11 years.

In response to these and other concerns, we also noted in our report, DVA had undertaken significant reforms of the program. These changes included a reduction in Cal-Vet interest rates, refinancing of $1.6 billion in outstanding bonds to achieve lower borrowing rates, reconfiguration of staff operations, a tightening of management of Cal-Vet insurance programs, and a speed-up in efforts to intervene when loans became delinquent.

As both our office and DVA had recommended, the Legislature also enacted Chapter 362, Statutes of 1998 (AB 2097, Margett) to do away with historic requirements that virtually all Cal-Vet loans always bear the same interest rate, giving the program the same flexibility enjoyed by all of its loan market competitors. The Legislature also enacted Chapter 530, Statutes of 1998 (AB 2096, Margett) to permit Cal-Vet borrowers to make a lower down payment when obtaining loans. As we had recommended, the bill also established a statutory requirement that loans in excess of

80 percent of the value of a home be backed up by loan guarantees or insurance instruments to protect the state's financial interests.

How Is the Program Performing Now? The various changes implemented by the DVA over the past two years have strengthened both the management of the program and its financial condition. In 1997-98, the Cal-Vet operating fund showed a small net profit (about $4.3 million or an amount equal to 1.6 percent of the state's equity in the program) for the first time in six years. Although the Cal-Vet program continues to fail to meet its internally established loan issuance targets, the number of new loans issued monthly has increased both in number and in total dollars loaned above 1996-97 levels.

However, as we advised the Legislature last January would likely be the case, these program reforms have not stemmed the rapid decline in the number of veterans holding Cal-Vet loans. As can be seen in Figure 1, the number of new loans issued each month to purchase homes still is not keeping pace with the number of loans ended as loan-holders paid off or defaulted on their loans or died. About three or four loans typically are retired monthly for every one new home purchase loan issued.

Thus, the size of the home loan portfolio declined by about 3,200 loans and $90 million during 1998 to end the calendar year with a portfolio of 34,653 loans. That amounts to an 8.5 percent drop in the number of Cal-Vet loans, and a 4.1 percent drop in the dollar amount of its mortgage pool, in one year. (The dollar level decreased at a lower rate than the number of loans because the newly issued loans are for larger amounts than the old loans being retired.) About $300 million in borrowing authority from Proposition 206, a Cal-Vet general obligation bond act, remains untapped three years after it received voter approval because the Cal-Vet mortgage pool is shrinking.

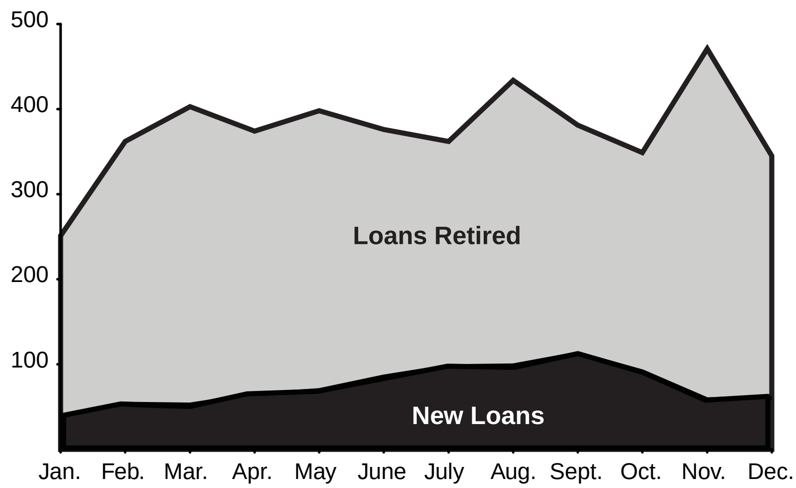
This shrinkage occurred despite a drop in the Cal-Vet loan rate from 8 percent to 6.95 percent on April 1, 1998, the mounting of aggressive direct-mail and other marketing efforts to attract new borrowers and an all-time record year in California for home sales. The DVA data indicate that the volume of new loans issued by the Cal-Vet program did increase after the April 1 interest rate cut. However, the same strong housing economy and lower interest rates that increased the issuance of new loans also spurred many existing Cal-Vet borrowers to sell their homes and pay off their outstanding Cal-Vet loan, or to refinance their homes with funds borrowed from other sources.

Cal-Vet has again cut its loan rates for new borrowers as of January 1, 1999, with most new loans issued at a 6.65 percent rate and others at 5.95 percent. While this step and other new efforts to market the program, such as by paying commissions to participating mortgage brokers, may stimulate more loan activity in the short term, we believe the long-term decline in the portfolio as shown in Figure 2 (see next page) will continue.

Figure 1

Loan Retirements Outpaced Issuance of New Loans[a]

1998



[a] General obligation and Revenue Bond sales for new homes.

Overhead Costs Continue to Grow. While the size of the loan portfolio has declined steadily, the state expenditures and staffing allocated by the DVA to administer the Cal-Vet program (which, under current law, are not subject to annual budget review by the Legislature) have stayed relatively stable over the last decade. For example, even though the size of the loan portfolio is dropping at an 8.5 percent annual rate, the 1998-99 workforce, as measured in full-time equivalent positions, is only 3.2 positions, or 1.3 percent, smaller than the workforce for the prior year.

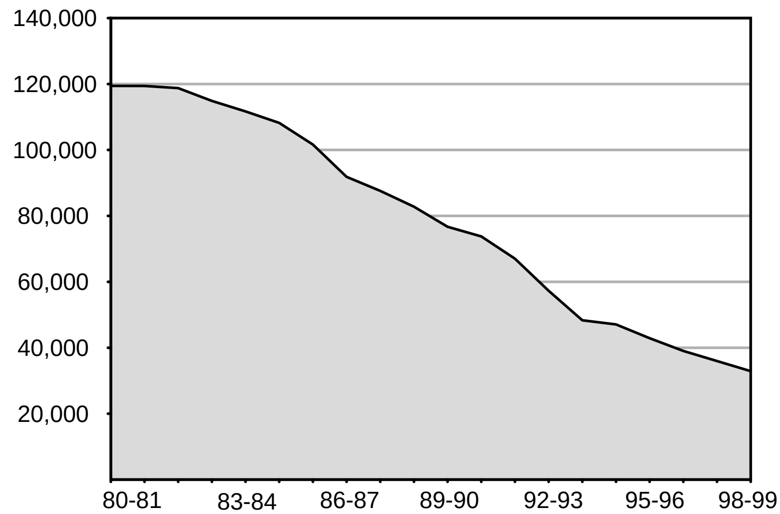
As shown in Figure 3 (see next page), the contraction in the size of the loan portfolio while administrative expenditures remained relatively stable drove up the overhead cost per loan in 1997-98 to $712. That compares with an overhead rate of $241 per loan in 1989-90 and $519 per loan in 1996-97.

Financial Position of Program Improves. Several factors have recently improved the financial performance of the Cal-Vet program. The steady

Figure 2

Number of Cal-Vet Loans Has Dropped

Loans in Portfolio

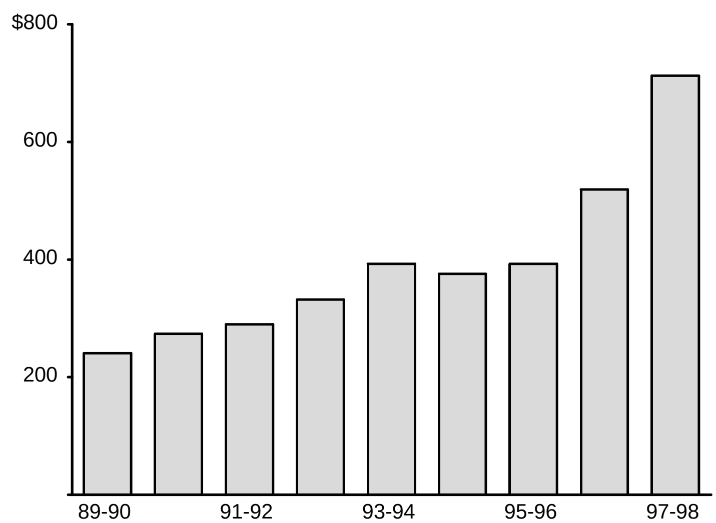


Note: 98-99 total is LAO projection.

Figure 3

Cal-Vet Overhead Costs Growing

Overhead Cost per Contract



flow of cash back into the program operating fund from the pay-off of existing loans has left the Cal-Vet program with almost $1.5 billion in cash and investment assets as of June 30, 1998. The investment of these funds in U.S. Treasury notes, corporate bonds, private investment agreements, and other financial instruments earned almost a $79 million return for the program in 1997-98, allowing it to register a small profit for the year of $4.3 million even though the money earned from mortgage payments ($162 million) fell far short of what Cal-Vet paid to retire the bonds originally sold to fund the mortgages ($219 million).

The refinancing of Cal-Vet debt last year to take advantage of low market interest rates for new bonds also improved the program's bottom line. Debt repayment costs are projected to drop by $50 million annually by 2002-03. If Cal-Vet's financial projections prove accurate, the program will grow increasingly profitable over the next five years and will be earning a net income of $71 million annually by 2002-03. Cal-Vet administrators now project that the state's equity in the program will grow by $200 million by 2002-03, reaching $485 million.

While these Cal-Vet financial projections are already proving to be overly optimistic, we are convinced that prudent management would result in the future generation of surplus revenues in excess of the operational needs or contractual obligations of the program. We are advised that, unless the voters were to grant their permission, these surplus funds would accumulate in the Cal-Vet operating fund and could not be spent to benefit veterans in other ways.

The *1999-00 Governor's Budget Summary* acknowledges these issues, and refers to a declining interest or need by veterans for home loans and an increasing need for other services for veterans. The budget plan indicates that the new Secretary of Veterans Affairs will report to the Governor by summer 1999 regarding the need for further restructuring of the Cal-Vet loan program and on ways that surplus funds in the Cal-Vet operating fund might be redirected to other pressing needs of veterans.

Analyst's Recommendation. Because the number of persons holding Cal-Vet loans has continued to decline while program overhead costs have continued to grow, we recommend that the Legislature take steps in 1999 to phase out new loan activity in the program by the year 2007 and seek voter approval to shift surplus Cal-Vet funds to other programs of greater benefit to veterans and state taxpayers.

The specific proposals are detailed in our January 1998 policy report on the Cal-Vet program and in the *1998-99 Analysis of the Budget Bill* (page G-125). Key elements of our plan include (1) a technical review to determine the timing and estimated level of surplus funds in excess of the operational needs or contractual obligations of the program, (2) a public hearing process by the California Veterans Board to solicit the views of the veterans' community regarding the best use of surplus funds, and (3) legislative action this year to place a measure on the March 2000 ballot seeking voter approval to use surplus Cal-Vet funds for new purposes that jointly benefit veterans and state taxpayers.

Adjustments Should be Made to Veterans' Homes Budgets

The budget proposes $86 million, including $49 million from the General Fund, for the continued operation of veterans' homes in Yountville and Barstow, and to open a new home in Chula Vista. We recommend a series of modifications of the budget requests for the three homes to avoid overbudgeting of General Fund resources and to maximize the expenditure of federal funds and reimbursements for support of these facilities. In addition, we withhold recommendation on some other expenditure requests pending receipt of additional information.

Background. 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 1,125 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 reduced 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 Veterans' Home of Southern California is planned to consist of four separate 400-bed facilities. The Barstow home in San Bernardino County was the first to open in February 1996 with a 120-bed SNF, a 60-bed ICF, and 220 domiciliary care beds. A third home in Chula Vista is now under construction and is scheduled to open by April 1, 2000, with a 120-bed SNF, a 60-bed ICF, 55 beds with residential care, and 165 beds with domiciliary care. Chapter 91, Statutes of 1997 (SB 584, O'Connell) provides that additional veterans' homes are to be established in the future in Lancaster in Los Angeles County and near the community of Saticoy in Ventura County.

The General Fund pays a significant share of the costs of operating the homes. The balance of support consists primarily of Medicare and Medi-Cal reimbursements for medical and nursing services, aid and attendance allowances from the U.S. Department of Veterans Affairs, and fees paid by home residents.

Costs for Homes Are High. The average cost per bed of operating the homes has long been high compared to public and private facilities providing similar services.

The average cost per day of operating a bed in Yountville's acute-care hospital in 1999-00 is estimated to be more than $1,800. That is more than double the average rate of $841 to be paid to California hospitals under the Medi-Cal program. Similarly, while the SNF unit at Yountville is projected to cost $295 per bed for each day of operation, other similar nursing facilities are paid $215 daily for the same services.

The cost increases have been especially significant at the Yountville home. If the 1999-00 budget for the home is approved as submitted, the average cost of an acute-care bed at Yountville would have increased by $170,000 each, or 35 percent, since 1997-98 due to declines in caseload and rising costs. (Yountville's 1998-99 costs were not compared because they include significant one-time costs for a new computer system.) Yountville SNF costs have also gone up, although much more modestly.

Barstow's nursing beds are proving to be less costly than Yountville's, but its domiciliary beds are almost twice as expensive on average to operate. Moreover, the share of domiciliary costs supported by the General Fund at the Barstow home in 1998-99 (almost $26,000 per bed) is eight times the cost at Yountville (about $3,700 per bed).

Overview of Analyst's Recommendations. Figure 4 (see next page) provides a summary of our recommendations regarding the veterans' homes in Yountville, Barstow, and Chula Vista. These recommendations are discussed in greater detail below.

Yountville Home Budget Issues. The proposed 1999-00 budget for operation of the Yountville home is $54 million, a decrease of $4.6 million, or 7.8 percent, below the current-year expenditure level. Of this sum, about $25 million, or 46 percent, of the support for the home would come from the General Fund. The decrease is because one-time funding of $4.9 million for a computer project at the home is not continued in 1999-00.

We recommend that the General Fund budget for Yountville be reduced by $514,000, with an offsetting and equal increase in reimbursements to take into account additional funding flowing to the home from 1998 cost-of-living increases in federal veterans' assistance programs.

We further recommend that the department report at May Revision budget hearings regarding the amount of further adjustments to the home's budget that are warranted to reflect: (1) increased revenues from 1999 cost-of-living adjustments in federal veterans' programs, (2) pending agreements with the U.S. Department of Veterans Affairs to increase reimbursements for pharmacy expenditures, (3) implementation of a Corrective Action Plan mandated by the Legislature last year to remedy problems in control of personnel and the home budget, and (4) implementation of a comprehensive management operation plan mandated by the Legislature last year that would analyze the staffing mix and mix of medical services provided at the home.

Figure 4

LAO Recommendations on Veterans' Home Budget Proposals

Yountville

- Reduce General Fund by $514,000 and increase federal funds and reimbursements by equal amount to reflect anticipated federal revenues.
- Report at May Revision regarding additional potential budget changes.
- Withhold recommendation on $385,000 requested for outside medical care for home residents because of pending study.

Barstow

- Reduce General Fund by $810,000 and increase federal funds and reimbursements by equal amount to reflect anticipated federal revenues.
- Report at May Revision regarding additional potential budget changes.

Chula Vista

- Approve $9.1 million in expenditures to activate the new home.
- Reduce General Fund by $513,000 for staffing and $920,000 for contract services because the proposed schedule for home occupation is unrealistic.
- Withhold recommendation on $1.8 million for Veterans Home Information System because a Feasibility Study Report for project awaits approval.
- Reduce General Fund by $108,000 for purchase of equipment the home has not identified.
- Withhold recommendation on $2.1 million for purchase of equipment for which cost documentation is lacking.
- Reduce General Fund by $81,000 for staffing to augment Sacramento budget office because proposed augmentation not justified.

We withhold recommendation on a proposed $385,000 General Fund augmentation to help pay the bills of home residents obtaining medical care outside of the home. We note that the home has previously been able to pay for these costs from within its existing budgeted funds. We believe this request is premature until the study that could lead to major changes in the home's medical care operations and staffing mix has been completed and submitted to the Legislature for review. This study could potentially identify efficiencies in the home's operations that could be used to offset the increased costs it is bearing for outside medical care for residents.

Barstow Home Budget Issues. The proposed 1999-00 budget for operation of the Barstow facility is about $17 million, an increase of about $200,000, or 1.2 percent, above the current-year expenditure level. About $10 million, or 61 percent, of the support for the home would come from the General Fund.

We recommend that the General Fund budget for Barstow be reduced by $810,000, with an offsetting and equal increase in reimbursements and federal funds expenditures. This recommendation takes into account additional funding flowing to the home from 1998 cost-of-living increases in federal veterans' assistance programs and other changes in home collections of federal funds and reimbursements.

We further recommend that the department report at May Revision budget hearings regarding the amount of further adjustments to the home's budget that are warranted to reflect: (1) increased revenues from 1999 cost-of-living adjustments in federal veterans' programs, (2) pending agreements with the U.S. Department of Veterans Affairs to increase reimbursements for pharmacy expenditures, (3) full implementation of the new Veterans Home Information System (VHIS), and (4) collection of reimbursements from third-party insurers of home members.

We would note that the Feasibility Study Report (FSR) justifying the $2.5 million VHIS computer project estimated that it would generate $1.5 million in increased home revenues from federal funds and reimbursements in the first year of implementation (originally to be 1995-96, but actually 1998-99 due to repeated delays in the project) and $6.9 million in the second year (now actually 1999-00). The increased revenues promised due to VHIS have not been included in the budget plan for the Barstow home. The 1999-00 budget also does not include any reimbursement revenues from third-party insurers, despite written assurances by the DVA to the Legislature that such a revenue collection effort would be undertaken after VHIS was implemented.

Chula Vista Home Budget Issues. The proposed 1999-00 budget for activation of the Chula Vista veterans' home is about $15 million. About 93 percent of the activation costs would come from the General Fund with the balance from federal funds and reimbursements.

As we discuss below, we recommend that the budget for the home be reduced by $1.6 million in General Fund expenditures and 18.3 personnel-years. We also withhold recommendation on another $3.9 million in proposed General Fund expenditures, to prevent overbudgeting of the home as it is phased into operation and to ensure that concerns over proposed equipment purchases and the cost-effectiveness of its computer system are resolved. We recommend approval of the remaining $9.1 million budgeted for the activation of the home in April 2000. Our specific recommendations are described below.

Our analysis indicates that the 1999-00 budget request is based upon unrealistic assumptions about how quickly the new home will be occupied by incoming residents. We would note that when funding was sought to activate the Barstow home, the DVA's overly optimistic assumptions in regard to the number of occupied beds resulted in the facility being over-budgeted by $5.4 million in 1995-96 and by $5.8 million in 1996-97. Notably, the initial budget request to activate Barstow assumed that the population of that home would phase in gradually, reaching 92 residents by the end of its third month of operation. In fact, the Barstow home population had only 32 residents by that time. Yet, the Chula Vista activation plan assumes that 313 residents will occupy beds in the new 400-bed facility within three months.

We believe that, because the Chula Vista home is in a location more likely to be preferred by veterans, the new facility will be occupied more quickly than Barstow (which as of November still had filled only 308 out of 400 beds). But we think it is unrealistic to believe, as the DVA assumes in its budget request, that all beds in the facility will be occupied by July 1, 2000. Accordingly, we recommend that the Chula Vista budget request be reduced by $513,000 and 16.8 personnel-years, to reflect a more reasonable pace for phasing in the beds. This reflects our assumption that one of two 60-bed SNF units and two of the four domiciliary buildings (about 80 beds) will not be needed during 1999-00.

Moreover, the amounts proposed in the budget for contracts for food service, laundry, housekeeping, and various specialized medical services cannot be justified even using the department's own assumptions about the occupation of the home. For example, the budget request includes $500,000 in 1999-00 for a contract for food preparation services at the home. Our analysis, based on a comparison of these costs with a similar contract at the Barstow home and a more realistic phase-in of the population at Chula Vista, indicates that this contract alone is overbudgeted by about $414,000. In summary, we recommend a total reduction for various contract services of $920,000.

We withhold recommendation on $1.8 million included in the budget request for development and installation of the VHIS at the Chula Vista facility. While such a computer project is needed to track and bill medical costs at the home and for many other important transactions, the DVA has yet to receive formal notification that its FSR on the project has been approved. (At the time this *Analysis* was prepared, we were advised that formal approval of the FSR was imminent.) Absent an approved FSR, the

Legislature cannot determine the costs, benefits, and technological feasibility of the VHIS project.

Based upon our analysis of the Chula Vista activation proposal, we recommend a $108,000 reduction for equipment purchases because the budget request inappropriately includes a lump sum amount for unidentified portable equipment purchases. We withhold recommendation at this time regarding another $2.1 million requested for equipment because, at the time of our analysis, the DVA was unable to document the cost of each item it wishes to purchase. Without this information, the Legislature cannot determine whether the amount requested is justified.

A $81,000 request to add 1.5 personnel-years in budget staff for the DVA's Sacramento office to handle budgetary matters related to the Chula Vista home should be denied, in our view. The work could be handled by the existing DVA budget office personnel with assistance from the staff provided in the budget request for administrative and accounting functions.

Analyst's Recommendation. We recommend that the budget requests for the Yountville, Barstow, and Chula Vista veterans' homes be modified as shown in Figure 5 below to avoid overbudgeting of General Fund resources and to maximize the expenditure of federal funds and reimbursements at these facilities. We further recommend that DVA report at May Revision budget hearings regarding other issues discussed above that could lead to other fiscal adjustments to the budgets of the Yountville and Barstow homes.

Figure 5

Net Fiscal Effect of Recommendations On Veterans' Home Budget Proposals

(Dollars in Thousands)

	Yountville[a]	Barstow	Chula Vista[b]
General Fund	-$514	-$810	-$1,622
Federal funds	—	+278	—
Reimbursements	+514	+532	—
Totals	**—**	**—**	**-$1,622**
Personnel-years	—	—	-18.3

a Also withhold recommendation on $385,000 in proposed General Fund expenditures.

b Also withhold recommendation on $3.9 million in proposed General Fund expenditures.

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 $347.3 million General Fund request for annuitant benefits pending final determination of premium rates for calendar year 2000.

The budget proposes total expenditures of $347.3 million from the General Fund for health and dental benefits for annuitants in 1999-00. This is $29.6 million, or 9.3 percent, more than estimated expenditures for this purpose in the current year. This increase reflects only expected growth in the number of annuitants. It does not include any changes in health premiums that would go into effect January 1, 2000. Figure 1 displays General Fund expenditures for annuitant health and dental benefits for the three fiscal years starting with 1997-98. 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 the budget year are dependent on negotiations over health premiums currently underway between the state and providers. These negotiated premium rates—which will cover the 2000 calendar year—should be available for review during legislative budget hearings. Pending receipt of the new rates, we withhold recommendation on the amount requested under this item.

Figure 1

Health and Dental Benefits For Annuitants

(In Millions)

Program	1997-98 Actual	1998-99 Estimated	1999-00 Budgeted
Health	$249.5	$285.1	$312.7
Dental	31.4	32.6	34.6
Totals	**$280.9**	**$317.7**	**$347.3**

AUGMENTATION FOR EMPLOYEE COMPENSATION (9800)

A significant portion of state government expenditures is for compensation of state employees. The Governor's budget projects $13.4 billion in salary and wage expenditures for more than 282,000 authorized personnel-years in 1999-00 (including $4.6 billion and nearly 90,000 personnel-years in higher education). Including benefits (such as contributions to retirement and health insurance), estimated employee compensation expenditures are projected to exceed $17 billion for the budget year.

The following employee compensation issues are discussed below:

- The administration's proposals for employee compensation.
- Negotiations for new collective bargaining agreements.

Employee Pay/Benefit Increases

State Civil Service Employees. Most state employees (other than those in higher education) last received a general pay increase (3 percent) on January 1, 1995. Figure 1 shows a history of general salary increases for state civil service employees and the consumer price indices for the United States and California since 1981-82.

In the current year, employees in four of the 21 bargaining units received general salary increases ranging from 3 percent to 10 percent. In addition, employees not represented by a bargaining unit received a 3 percent salary increase.

The Governor's budget includes a total of $358 million ($164 million General Fund and $97 million each from special funds and nongovernmental cost funds) to provide increased compensation to state employees other than employees in higher education. The $358 million consists of (1) $168 million ($64 million General Fund) for the annual cost of any increases in employee compensation that are approved in the current year for employees currently in collective bargaining negotiations and (2) $190 million ($100 million General Fund) for employee compensation changes that may be agreed to through collective bargaining and become effective in the budget year. As discussed below, actual salary increases provided to employees by these funds are dependent on the terms of negotiated agreements. As an example, however, the $168 million amount could cover the annual cost of an average pay increase of 3 percent for those currently in collective bargaining. The $190 million that would be available for changes in the budget year could provide an additional salary increase of 2 percent for all employees.

Figure 1

State General Salary Increases

1981-82 Through 1999-00

Fiscal Year	State General Salary Increase	Consumer Price Index	
		United States	California
1981-82	6.5%	8.8%	10.7%
1982-83	—	4.2	2.3
1983-84	6.0	3.7	3.6
1984-85	8.0	3.9	4.9
1985-86	6.0	2.9	4.0
1986-87	6.0	2.2	3.3
1987-88	3.8	4.1	4.2
1988-89	6.0	4.6	4.8
1989-90	4.0	4.8	5.0
1990-91	5.0	5.5	5.3
1991-92	—	3.2	3.6
1992-93	—	3.1	3.2
1993-94	5.0	2.6	1.8
1994-95	3.0	2.9	1.7
1995-96	—	2.7	1.4
1996-97	—	2.9	2.3
1997-98	—	1.8	2.0
1998-99[a]	—[b]	2.0	2.1
1999-00[a]	—[c]	2.6	2.8

[a] Department of Finance estimate of consumer price indices.

[b] Appropriated funds provided general salary increases of 3 percent to 10 percent for about 32,000 employees in 4 of the 21 bargaining units and a 3 percent salary increase for nonrepresented employees.

[c] Governor's budget proposal is equivalent to about a 2 percent general salary increase for all employees.

The Governor's budget indicates that the amount ultimately needed for employee compensation increases is dependent on reaching agreement with the 21 employee bargaining units through the collective bargaining process. In recognition of this, the budget bill includes provisional language stipulating that (1) the amount in the bill is not to be construed to control or influence the collective bargaining process and (2) the funds are to be distributed in accordance with approved memoranda of understanding (MOUs) for represented employees and based on salary and benefit schedules established by the Department of Personnel Administration (DPA) for nonrepresented employees. As discussed below, five of the 21 employee bargaining units have reached agreement on MOUs for the current year and the Legislature has approved four of them.

Employees in Higher Education. The University of California (UC) budget request sent to the Governor included a total of $97 million for employee compensation to provide salary and benefit increases to faculty and staff. Similarly, the California State University (CSU) requested $103 million for salary and benefit increases to faculty and staff. The Governor's budget, however, includes less *total* funding support for UC and CSU than requested and indicates that UC and CSU will develop specific budget plans in the spring to allocate the proposed funds (including monies for employee compensation). Consequently, the amount in the budget for employee compensation is unknown at this time.

New Collective Bargaining Agreements Still Under Negotiation

To strengthen the Legislature's oversight of collective bargaining, we recommend that the Legislature require a minimum 30-day review period for collective bargaining proposals and review proposals at budget hearings for adoption in the budget act. Further, 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 DPA began negotiations in 1995 with the 21 bargaining units representing rank-and-file state employees (other than higher education) for new MOUs governing compensation and other terms and conditions of employment. These MOUs were to replace those that expired June 30, 1995. (Under current law, the provisions of expired MOUs generally remain in effect pending adoption of replacement MOUs.)

In 1998, DPA reached agreement with four of the 21 units and the Legislature approved these MOUs—California Correctional Peace Officers Association; California Department of Forestry Firefighters; Physicians, Dentists, and Podiatrists; and Health and Social Services/Professional. These MOUs are in effect until June 30, 1999. In addition, DPA has reached a tentative agreement with the California Highway Patrol, but at the time this *Analysis* was written the Legislature had not approved the MOU. This MOU, if approved, would also be in effect until June 30, 1999.

The Governor has indicated his desire to reach an early agreement with the remaining 16 bargaining units in the current year and also to reach agreement with all units for MOUs that would be effective after June 30, 1999. If this occurs, the Legislature will be presented with a large number of MOUs to consider over the next several months.

Strengthen Legislature's Collective Bargaining Oversight. In the past, the Legislature has received MOUs for approval late in the session. In addition, assessments of the total cost of the MOUs have not always been available or complete for consideration with the proposals. To ensure that the Legislature has the opportunity to appropriately review any proposed MOUs, we recommend that the Legislature (1) require a minimum 30-day review period between the submittal of proposed MOUs to the Legislature and hearings on the proposals to ensure that their fiscal and policy implications are fully understood and (2) review the administration's MOU proposals at budget hearings and adopt them in the annual budget act (or as amendments to the act if they are not available for review during budget hearings). This is consistent with our recommendation in past *Analyses* and with supplemental report language adopted by the Legislature with the *1996-97 Budget Act*. Given this need to strengthen the Legislature's oversight of collective bargaining agreements, we further recommend that DPA report to the budget committees during budget hearings on the administration's collective bargaining proposals and the status of negotiations.

TAX RELIEF
(9100)

The state provides tax relief—both as subventions to local governments and as direct payments to eligible taxpayers—through a number of programs contained within this budget item. The budget proposes total relief of $1.6 billion, of which almost $539 million is appropriated through the budget bill.

Of the items appropriated in the budget bill, the homeowners' exemption is the largest. This provision, which is required by the State Constitution, 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 reduction in property tax revenues. The exemption reduces the typical homeowner's taxes by about $75 annually. The Governor's budget proposes an expenditure of $401 million on this program in 1999-00. This is an increase of almost $6 million, or 1.5 percent, which reflects the expected growth in the number of homeowners claiming the exemption.

A number of the other tax relief programs were altered by the 1998 tax relief package implemented through Chapter 322, Statutes of 1998 (AB 2797, Cardoza), as discussed below.

1998 Tax Relief Package Increases Program Costs

Vehicle License Fee Relief. The 1998 tax relief package included a permanent reduction in the vehicle license fee (VLF) of 25 percent beginning January 1, 1999, with the potential of greater reductions beginning in 2000-01 if General Fund revenues grow faster than currently projected. Cities and counties receive most of the proceeds of the VLF, more than $3.6 billion in 1997-98. As part of the tax reduction agreement, cities and counties will continue to receive the same amount of revenues as under prior law, with the reduced VLF amounts replaced by General Fund spending. This General Fund spending is continuously appropriated and, therefore, does not appear as an item in the budget bill. The fiscal impact in 1998-99 is estimated at $557 million—with the first full fiscal year effect occurring in the budget year at about $1.08 billion.

Renters' Credit. The renters' credit program—which provides a personal income tax credit to Californians who rent their principal place of residence—was reinstated by Chapter 322, after having been suspended since 1993. In its reconstituted form, the renters' credit is nonrefundable and income-limited. The amount of the credit is $60 for single renters and $120 for married couples or heads of households, but not to exceed the filer's tax liability. Beginning with the 1998 tax year, the credit will be made available to single renters with incomes up to $25,000, and to married couples or heads of households with incomes up to $50,000. The estimated cost of the program in 1999-00 is $141 million. However, this cost is no longer shown as an expenditure in Item 9100; instead, it is shown as a revenue loss to the personal income tax.

Senior Citizens' Relief. Two programs provide property tax assistance to low-income homeowners and renters who are either senior citizens (age 62 or older), disabled, or blind. For homeowners, the tax assistance is provided in the form of a partial reimbursement of property taxes paid; for renters, the amount of assistance is based on an estimate of the property tax paid by the renter. For 1999-00, the income eligibility limits for these programs is increased to slightly more than $33,000, up from $13,200 in 1998-99. Consequently, many more Californians will be eligible for the programs, and expenditures for the two programs combined are expected to rise from $16.6 million in 1998-99 to $83.6 million in the budget year. Due to these changes, an estimated 17,000 new homeowners and 215,000 new renters will benefit from the programs.

LOCAL GOVERNMENT FINANCING (9210)

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

- ***Citizen's Option for Public Safety (COPS).*** The COPS program was created in 1996 to provide local governments with funds for law enforcement. The budget proposes to again fund the program at $100 million in 1999-00, and we discuss the Governor's proposed changes to the program below.
- ***Special Supplemental Subventions.*** Two programs provide specified local governments with special funding: (1) qualifying redevelopment agencies for revenues lost as a result of the repeal of the business inventory exemption subvention in 1984 ($5 million) and (2) counties with no incorporated cities on the basis that they are not eligible to receive the city portions of the gas tax and vehicle license fee distributions ($147,000).
- ***State-Mandated Local Programs.*** This item includes funding to reimburse local governments for costs incurred in complying with certain state-mandated programs ($6 million).

This item also includes spending on the property tax administration loan program. This program was created by Chapter 914, Statutes of 1995 (AB 818, Vasconcellos) and extended through 2000-01 by Chapter 420, Statutes of 1997 (AB 719, Torlakson). This legislation appropriates $60 million each year for loans to counties for additional spending on property tax administration. These loans may be forgiven if counties can demonstrate that they have generated or preserved sufficient property tax revenues for schools to offset the costs of the loans. When the loans are forgiven, a cost is accrued in Item 9210. The budget recognizes a cost of $50 million for this purpose in both 1997-98 and 1998-99. The budget, however, shows no estimated costs for 1999-00, apparently on the basis that it is not known if any loans will be forgiven. It is most likely, though, that the state will incur costs of approximately $50 million in the budget year as loans are forgiven. Thus, we have assumed this spending amount in our assessment of the state's overall fiscal condition.

COPS Funding Should Be Considered In Larger Context of Local Fiscal Relief

We recommend the Legislature reject the Governor's proposal to modify and make permanent the Citizen's Option for Public Safety (COPS) program. Instead, we recommend that the Legislature consider the COPS monies in the larger context of state resources provided to restore the fiscal health of local governments. Specifically, we suggest that any local government relief funds that may be provided be used to transform California's system of local government finance into one that reflects modern needs and preferences of local communities.

Background. In 1996, the Legislature enacted Chapter 134, Statutes of 1996 (AB 3229, Brulte), which created the COPS program. Under this program, counties and cities receive state funds, on a population basis, to augment public safety expenditures. The Legislature has provided $100 million for the program each year since 1996-97.

Under the terms of Chapter 134, the $100 million of COPS funds is allocated as follows:

- $75 million to cities and counties for front line law enforcement.
- $12.5 million to district attorneys for criminal prosecution.
- $12.5 million to sheriffs for county jail construction and operations.

Chapter 289, Statutes of 1997 (AB 1584, Prenter) clarified the reporting requirements of the program and required the State Controller to compile a summary report on the allocation and expenditure of the COPS funds. At the time this *Analysis* was prepared, no such report has been submitted to the Legislature because, according to the Department of Finance, not all local governments have provided their information on the expenditure of the funds to the Controller. Chapter 289 also provides that the program sunsets at the end of 1999-00 absent new legislation.

The Governor's Proposal. The Governor's budget proposes to continue this program at the same $100 million funding level, but in the Governor's budget summary, the administration indicates that it will propose legislation that would change the program. First, the Governor indicates that he will propose that the program be made permanent, rather than expiring on June 30, 2000. Second, the Governor indicates that the legislation will require that all of the money be spent on front line law enforcement, and will provide an incentive for it to be used to hire new officers. Specifically, local governments that use the money to hire officers would receive the funds with no local match required, but governments that propose to use the money for other purposes, such as equipment purchases, would have to match the state funds on a dollar for dollar basis. According to the administration, these changes are in response to concerns expressed by law enforcement agencies that they were unable to use the funds to hire new officers because of the uncertainty of future appropriations.

At the time this *Analysis* was prepared, it was not clear whether the Governor's proposal would mean the elimination of the $25 million that previously went to district attorneys for prosecution and sheriffs for jail construction and operations, or whether the administration intends to apply the new conditions only to the $75 million portion.

Analyst's Concerns With the Existing COPS Program. In the *1997-98 Budget: Perspectives and Issues* we detailed our concerns regarding the COPS program. Specifically, we evaluated how the program met four basic criteria for a state-funded local public safety program.

- ***Targeted to Specific Statewide Objectives.*** We believe that a prudent expenditure of state resources for local law enforcement should be targeted to the achievement of specific statewide objectives. As it presently stands, the COPS program simply seeks to increase the overall funds for public safety by $100 million with little focus on meeting specific objectives.

- ***Includes an Evaluation Requirement.*** In addition to establishing objectives that a state funded program should strive to achieve, recipients of state funds should be required to evaluate their efforts in order to measure their success. The COPS program requires no such evaluation, and the minimal reporting requirements that are in place do not appear to have been met, as no report on the program has been produced.

- ***Facilitates Information Sharing.*** While the state is not in a good position to direct or provide for local public safety, it can be an excellent source for information on what is working well in the many jurisdictions in the state. There is no requirement or mechanism for information sharing in the COPS program.

- ***Allocated Competitively.*** Competitive allocation of state funds for public safety allows the state to reward excellence in planning and program design. In addition, it allows smaller jurisdictions an opportunity to obtain more than just a token amount of funding, and provides an incentive for jurisdictions to band together to jointly obtain funds for regional projects. Although competitive allocation does add some administrative cost, the overall return on the investment of state money should also be much greater. The COPS program funds, however, are distributed on a population basis, not on a competitive basis.

The Governor's Proposal Does Not Remedy the Program's Deficiencies. In our view, the COPS program fails when measured against the criteria outlined above. The Governor's proposal to make it permanent will only exacerbate the problems by establishing an ongoing commitment for which there is little accountability. In addition, we have other concerns about the Governor's proposal that we outline below.

Allocations Will Be Too Small For Many Jurisdictions to Hire More Officers. Although the Governor's proposal to change the incentive structure does attempt to go further in identifying an objective for the program—hiring more front line law enforcement personnel—it is not workable in a majority of jurisdictions because their allocations would be so small. If $75 million of the funds were allocated among the approximately 530 local law enforcement agencies, about 296 agencies, or 56 percent, would receive such a small amount of money that they would be unable to hire even one full-time officer. If the program is changed so that all $100 million goes to front line law enforcement, we believe that 255 agencies would still be unable to support one officer. As a result, these smaller agencies will be forced to find local funds either to match the COPS money in order to use it to purchase equipment or to supplement the costs of hiring an officer.

Hiring of Additional Officers Not Always the Best Course of Action. Beyond the practical difficulties of achieving this objective in smaller jurisdictions, we believe that there is a policy question as to why the state should prefer that agencies hire new officers rather than purchase equipment. Some of the agencies that received COPS money used it to purchase new technology that allows them to be more efficient in their tracking, response, and investigation. We see no reason to prefer hiring new officers to these attempts to use existing personnel more efficiently.

Moreover, the Governor's proposal includes no specific objective that these new officers are intended to achieve. Research has demonstrated that different types of policing produce different results in terms of crime control, yet there is no direction in the COPS proposal as to what law enforcement objective is to be met. By way of contrast, the federal money that has been awarded to law enforcement agencies has been directed towards specific goals, primarily the implementation of community oriented policing services.

Redirection of Prosecution and Jail Money May Not Be in Best Interest of State and Local Government. Finally, if the administration is proposing to redirect the $25 million that previously went to counties for jails and district attorneys to front line law enforcement, we question whether the demands for more funding for front line services are any more pressing than for prosecution or local incarceration. Moreover, adding personnel in front line law enforcement tends to increase the workload for downstream criminal justice agencies by increasing the number of arrests and convictions. As a result, it is shortsighted to increase enforcement capacity without making some corresponding increase in resources for prosecution and punishment.

What Should the Legislature Do? We have outlined a number of concerns about the COPS program, both as it is currently structured and as it is proposed for modification. Based upon our review, we recommend that the Legislature reject the Governor's proposal. Should the Legislature choose to continue to appropriate funds for local public safety, we suggest that the criteria we outline be used to establish such a program.

Our analysis indicates that the use of the COPS monies should really be part of a broader discussion of local government finance. As we outline in our recent report, *Shifting Gears: Rethinking Property Tax Shift Relief*, we believe that the Legislature should consider the $100 million set aside for the COPS program in the larger context of state resources provided to restore the fiscal health of local governments. Specifically, we suggest that any local government relief funds that may be provided be used to transform California's system of local government finance into one that reflects modern needs and preferences of local communities

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, 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.

The condition of the Public Employees' Retirement Fund, as of June 30, 1998, is one factor that will determine the 1990-00 state retirement contribution rates. Given the positive performance of the stock market through that date, we expect the downward trend in the state's contribution rates to continue, resulting in savings to the state. As an example, if the state's average contribution rate fell 1 percent, the General Fund savings would be about $50 million.

Consequently, we withhold recommendation pending final determination of 1999-00 rates and receipt and review of information from PERS regarding the actuarial assumptions underlying the determined rates. This information is typically available in March or April.

CONTROL SECTION 15.00

STEPHEN P. TEALE DATA CENTER REVOLVING FUND

Budget Proposes to Transfer Large Portion of Fund Balance

Control Section 15.00 would transfer from the Stephen P. Teale Data Center Revolving Fund to the General Fund and other funds an amount determined by the Department of Finance to be in excess of a sufficient balance in the fund. The Governor's Budget proposes to transfer $22.7 million from the balance in the budget year, which includes $11.3 million that would be returned to the General Fund and $11.4 million that would be returned to various special funds.

In our analysis of the Stephen P. Teale Data Center earlier in this chapter, we withhold recommendation on the proposed transfer of balances in the revolving fund pending receipt and review of additional information (please see our analysis of the Teale Data Center).

VARIOUS BUDGET-RELATED CONTROL SECTIONS

We withhold recommendation on proposed budget bill changes relating to expenditure authority delegated to the administration, pending further discussions with Legislative Counsel and the administration.

Through various budget bill provisions, the Legislature delegates to the administration the ability to spend money not specifically authorized in the annual budget act. Specifically:

- ***Section 26.00.*** This section allows the Department of Finance (DOF) to authorize the transfer of funds from one category of expenditure to augment a different category of expenditure within the same schedule.
- ***Section 27.00.*** This section authorizes a department to spend at a rate that will result in a deficiency by the end of the fiscal year.
- ***Sections 28.00 and 28.50.*** These sections allow the administration to spend unanticipated funds that come in after the start of the fiscal year (or reduce spending allocations). Typically, these are federal funds (Section 28.00) and reimbursements (Section 28.50)—*not* state revenue sources.

For all four sections, there is a 30-day notification period to the Legislature. This means that the administration may not approve additional spending authority before the Legislature—through the Joint Legislative Budget Committee—has had an opportunity to review the proposal. The basic reason for the Legislature to delegate this authority to the administration is to deal with certain unforeseen circumstances, especially when the Legislature is not in session (primarily during the fall).

Proposed DOF Changes. The changes proposed by the department generally fall into two categories—increased dollar thresholds before JLBC notification becomes necessary and opening up certain control sections to include local assistance and capital outlay. For instance, the department proposes raising the threshold for JLBC notification of intraschedule transfers (Section 26.00). Likewise, the department proposes to permit capital outlay projects to spend at rates that will incur deficiencies.

Given the importance of these budget provisions, it is crucial that the Legislature understand the reasons for the proposed changes. We will be discussing these issues further with DOF and Legislative Counsel and will report to the subcommittees at budget hearings on our recommendations. At this time, however, we withhold recommendation on the proposed changes.

FINDINGS AND RECOMMENDATIONS

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Crosscutting Issues

Information Technology

1. **Legislature Should Focus on Key Questions.** There is no single reason that information technology projects fail. If the Legislature focuses and acts on key questions during its review of information technology projects, the chances of failure should diminish. F-13

Regulatory Activities

Department of Insurance

2. **Additional Funding for Holocaust Claims Program.** Withhold recommendation on the request for a $1 million General Fund loan to the Insurance Fund to investigate insurance claims relating to the Holocaust, pending receipt and review of the Department of Insurance plan for reimbursement of expenses, as required by Chapter 963, Statutes of 1998 (SB 1530, Hayden). F-30

California State Lottery Commission

3. **The Bridget Project.** The commission should provide the Legislature with information demonstrating that the Bridge Project and associated administrative changes and revenue distribution have furthered the purpose of the Lottery Act by increasing revenues to education. F-32

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4. **Legislative Oversight of the Commission's Administration Budget.** Recommend that the Legislature include the commission's administration budget in the current and subsequent annual budget bills as an informational item.	F-33

Consumer Affairs

5. **State Implementation Plan Requirements.** Recommend the Legislature not approve the requested $71 million for the Smog Check program until the bureau reports on the status of the Smog Check program and whether the program is still on track for meeting the requirements of the State Implementation Plan as agreed to by the state and the federal Environmental Protection Agency. Further recommend that since the Air Resources Board and the Inspection and Maintenance Review Committee are both responsible for monitoring the Smog Check program they each provide their assessment of the program as well.	F-37
6. **Low-Income Repair Assistance and Vehicle Retirement Programs.** Withhold recommendation on the $62 million and 91 personnel-years for the Low-Income Repair Assistance Program (LIRAP) and Voluntary Retirement Program (VRP) pending receipt and review of the bureau's evaluation report.	F-40
7. **Remote Sensing Not Being Implemented.** Recommend the Legislature not approve any funding for remote sensing until the bureau provides (1) an accounting of the current-year remote sensing appropriation and (2) a complete plan for the uses of and schedule for remote sensing.	F-41
8. **Enforcement Augmentation Not Justified.** Recommend the bureau provide information regarding the enforcement activity (such as undercover audits and licensee investigations) currently performed by the	F-42

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bureau. This information should include a discussion of the bureau's assessment of the necessary level of enforcement and justification for the requested 20 percent increase.

9. **Budget Bill Schedule**. Recommend the Legislature add separate items to the budget bill for the Smog Check program appropriations, including the LIRAP and VRP to enhance legislative oversight and improve visibility and accountability of the programs. F-42

Department of Alcoholic Beverage Control

10. **License Fees Should Be Increased.** We recommend the Legislature amend the Alcoholic Beverage Control (ABC) Act to permit the ABC to increase fees. Further any increase should be limited to the amount needed to fund legislatively approved spending each year and a prudent reserve. F-44

Office of Real Estate Appraisers

11. **Fund Balance and Revenue.** Withhold recommendation on the proposed 1999-00 budget until receipt and review of a strategic plan addressing the office's budgetary imbalance. F-47

12. **1998 State Auditor Report.** The office should, prior to budget hearings, provide a detailed up-date of the office's progress in responding to the concerns raised in the March 1998 State Auditor report. F-48

Energy Resources, Conservation and Development Commission

13. **Legislature Should Review Energy Facilities Siting Program.** Withhold recommendation on the request for a $1,247,000 augmentation and ten positions for the F-50

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Energy Facilities Siting Program until the Legislature reviews the commission's role in siting energy facilities under the deregulated market for electricity generation. Further withhold recommendation on the existing staffing level and funding (75 positions and $9.5 million) for the siting program, pending the Legislature's review of the commission's siting role.

Department of Food and Agriculture

14. **Fee Structure. Reduce Item 8570-001-0001 by $93,000.** F-53
Recommend the Legislature require the Department of Food and Agriculture to implement a fee schedule that provides for 100 percent cost recovery for testing services for (1) regulated industries provided by the Veterinary Diagnostic Laboratory (this will result in additional fee revenue and reduce the General Fund support) and (2) the private veterinarians and producers (this action will result in $93,000 in additional fee revenue and a corresponding decrease in General Fund support).

15. **Budget Bill Schedule. Reduce Item 8570-001-0001 by** F-55
$9,709,000 and add Item 8570-004-0001 totaling $9,616,000. Recommend the Legislature create a new budget bill item to separately identify the California Veterinary Diagnostic Laboratory System operating costs in order to enhance legislative oversight.

Fair Political Practices Commission

16. **Further Audit Compliance Steps Needed.** The Fair F-57
Political Practices Commission (FPPC) has improved its operations but has not fully complied with legislative directives to strengthen enforcement. Recommend FPPC provide additional information to the Legislature by April 1, 1999 on how it will do so. Further recommend enactment of legislation that would allow FPPC

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to focus its enforcement efforts on the most serious violations and to strengthen the penalties that it can impose.

Public Utilities Commission

17. **Compliance With "Cramming" Statutes.** Withhold recommendation on the $1,035,000 augmentation and 19 positions requested to comply with recent legislation addressing the problem of "cramming," pending review of additional workload data to justify the requested staffing level and associated funds. F-61

Tax Programs

Board of Equalization

18. **Audit and Collections Program Augmentation. Reduce Item 0860-001-0001 by $4,898,000 and Item 0860-501-0995 by $1,076,000.** Withhold recommendation on $6 million ($4.9 million General Fund) augmentation and 116 new audit positions until the department provides sufficient justification for the increased audit effort. F-63

Franchise Tax Board

19. **Tax Program Augmentations Not Justified. Reduce Various Items by a Total of $8,242,000 ($8,056,000 General Fund) and 73.2 Personnel-Years.** We recommend the Legislature delete the proposed augmentations totaling $8.2 million and 73.2 personnel-years from various funds for support of the Franchise Tax Board's tax program. These augmentations have not been justified. F-65

20. **Performance Audit.** We recommend the department provide the Legislature with information on why tax program reductions recommended by a performance F-67

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audit have not been implemented. Pending receipt and review of this information we withhold recommendation on $7.4 million in the department's budget.	
21. **Integrated Nonfiler Compliance Project.** We withhold recommendation on the $6.9 million General Fund requested for the Integrated Nonfiler Compliance project. The project has not yet been approved by the Department of Information Technology.	F-69
22. **Business Tax Reporting Mandate.** If the Legislature determines that suspending the business tax reporting mandate is appropriate, we recommend that the Legislature also delete the positions associated with the program workload. The department should identify these positions prior to budget hearings.	F-70
23. **Budget Control Language. Delete Provision 1 Under Item 1730-001-0001.** Recommend deletion of proposed budget bill language that would add administrative controls over the board.	F-70

Information Technology

Department of Information Technology

24. **Sunset Provides Opportunity for Review and Improvement.** Statutory provisions that created the Department of Information Technology (DOIT) will expire at the end of the budget year. Recommend Legislature enact legislation to extend the life of DOIT, and consider a number of other changes.	F-72
25. **Status of Year 2000 Correction.** Recommend DOIT provide detailed report prior to budget hearings on status of efforts to fix state's computers to accommodate century change.	F-75
26. **Study Not Provided.** The DOIT did not provide study on siting and configuration of the state's data centers as directed in supplemental report language.	F-78

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Stephen P. Teale Data Center	
27. **Transfer of Fund Balances.** Withhold recommendation on transfer contained in Control Section 15.00, pending receipt and review of proposed trailer bill legislation designed to reduce potential cash-flow problems for the center and a revised breakdown of the amounts of money that would be returned to the General Fund and the individual other funds.	F-80
Health and Welfare Agency Data Center	
28. **Status of the Projects.** The major social services-related information technology projects are at various stages of development. It is likely, however, that the administration will request substantial changes to the proposed expenditures for the projects prior to enactment of the *1999-00 Budget Act*.	F-83
State Administration	
State Controller	
29. **New Human Resources Management System.** The State Controller's Office began work on system in current year prior to final review of the Legislature. Budget proposes to continue the project in the budget year.	F-90
Department of General Services	
30. **Public Safety Microwave Network Master Plan Needed.** Recommend adoption of supplemental report language directing the department to develop a master plan for the network. Further recommend that the Legislature not fund any additional changes to the network until completion of the master plan.	F-92

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Housing and Community Development

31. Increase Effectiveness of New Housing Dollars. Recommend that $10 million proposed for new spending on housing be held in reserve and allocated by legislation that takes into account the Housing Task Force's recommendations**.** **F-98**

32. Effort to Reduce Mobilehome Title Backlog. Withhold recommendation on the approval of 43 positions, pending additional updates on ongoing workload and productivity levels. F-99

Trade and Commerce Agency

33. **Commission of the Californias. Reduce Item 2920-001-0001 by $250,000.** Recommend that the Legislature delete the request for $250,000 from the General Fund and two positions to augment existing resources for the Office of California-Mexico Affairs because the agency has not justified the request. F-101

34. **Foreign Trade Offices.** Withhold recommendation on the $5.8 million requested from the General Fund for the agency's foreign trade offices pending receipt of the reports the Legislature requested in 1998-99. F-102

Department of Personnel Administration

35. **Replacement of Payroll/Personnel System. Delete $604,000 From Item 8380-001-0001.** Recommend that the Legislature not approve the request for $604,000 from the General Fund and six one-year limited-term positions for the Department of Personnel Administration (DPA) to participate in the State Controller's project to replace and upgrade the state's payroll/personnel system because DPA has not provided sufficient justification for the request. F-105

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36. **Collective Bargaining Agreements.** The DPA should report to the budget committees during budget hearings on the administration's collective bargaining proposals and the status of negotiations.	F-106

Military Department

37. **Redirect Armory Homeless Shelter Funds to Counties.** Recommend that the $1 million provided to the department to use its armories as emergency winter homeless shelters be redirected to all counties as grants through the Emergency Housing Assistance Program.	F-108

Department of Veterans Affairs and Veterans' Homes of California

38. **Decline in Cal-Vet Portfolio.** Number of veterans with loans still dropping despite efforts to stabilize the portfolio with interest rate cuts and new marketing efforts. Recommend legislation in 1999 to phase out new loan activity by 2007 and to seek voter approval to shift surplus funds to other needed veterans' programs.	F-110
39. **Home Budgets Should Be Adjusted.** Recommend series of modifications of budget requests for the Yountville, Barstow, and Chula Vista veterans' homes to avoid unnecessary overbudgeting of General Fund resources, and withhold recommendations on several other spending proposals pending receipt of additional information.	F-116

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State Employment and Retirement

Health and Dental Benefits for Annuitants

40. **Budget-Year Costs Are Uncertain.** Withhold recommendation on the $347.3 million General Fund request for health and dental benefits for annuitants pending final determination of premium rates. F-122

Augmentation for Employee Compensation

41. **Legislature Needs to Strengthen Its Collective Bargaining Oversight.** Recommend that the Legislature require a minimum 30-day review period for collective bargaining proposals and review proposals at budget hearings for adoption in the budget act. Further, 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. F-126

Local Government

Local Government Financing

42. **Citizen's Option for Public Safety Program Modifications Should Be Rejected.** Recommend rejection of Governor's proposal to make program permanent and to modify it to give preference to hiring of front-line law enforcement. Rather, recommend that the funds be used as part of a larger strategy to transform California's system of local government finance into one that reflects modern needs and preferences of local communities. F-131

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Control Sections

Control Section 3.60

43.	**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.	F-135

Various Budget-Related Control Sections

44.	We withhold recommendations on various budget-related control sections pending further discussions with Legislative Counsel and the administration.	F-137