

**AGENDA****ASSEMBLY BUDGET SUBCOMMITTEE NO. 3 RESOURCES AND TRANSPORTATION****ASSEMBLYMEMBER RICHARD BLOOM, CHAIR****WEDNESDAY, APRIL 10, 2013****9:00 A.M. - STATE CAPITOL ROOM 447**

<b>ITEMS TO BE HEARD</b>		
<b>ITEM</b>	<b>DESCRIPTION</b>	
<b>2660</b>	<b>CALTRANS</b>	1
ISSUE 1	RECENT AUDIT FINDINGS	1
ISSUE 2	PROPOSITION 1B CAPITAL REQUESTS	2
ISSUE 3	ZERO-BASED BUDGETING LOCAL ASSISTANCE	3
ISSUE 4	ZERO-BASED BUDGETING PLANNING	7
ISSUE 5	CASH MANAGEMENT TRAILER BILL LANGUAGE	9
ISSUE 6	INDIRECT COST ALLOCATION PLANS AUDITS	10
<b>2665</b>	<b>HIGH SPEED RAIL AUTHORITY</b>	11
ISSUE 1	OVERVIEW OF HIGH SPEED RAIL	11
ISSUE 2	GOVERNOR'S BUDGET PROPOSALS FOR HIGH SPEED RAIL	14
<b>2740</b>	<b>DEPARTMENT OF MOTOR VEHICLES</b>	18
ISSUE 1	DMV BUDGET PROPOSALS	18
ISSUE 2	INFORMATION TECHNOLOGY MODERNIZATION PROJECT	20

**ITEMS TO BE HEARD**

**2660 CALTRANS**

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**ISSUE 1: RECENT AUDIT FINDINGS**

On March 28, 2013, the Bureau of State Audits issued a report that summarized their findings of a Whistleblower investigation against two staff at Caltrans.

**BACKGROUND**

The Auditor issued a report on March 28, 2013, which summarizes the results of an investigation that began in 2009.

The audit had three findings:

1. Two employees had falsely claimed \$13,788 in overtime
2. One technician had falsified data in certain engineering testing, called “gamma gamma logging” testing ten times.
3. A supervisor had employee's misappropriated state resources for his own private use.

The audit faults Caltrans supervisory practices for approval of overtime and for verification of testing.

The report noted that Caltrans had reviewed its 224,104 “gamma gamma logging” testing files to determine if other results were falsified and were able to find 11 cases of falsified data. Of these, the one technician had falsified data 10 times. The other falsified test could have been attributed to one of two engineers, but Caltrans could not determine which one was at fault.

In addition, all of the falsified tests that were detected were retested and the structures were found to be structurally sound.

**STAFF COMMENT**

The Auditor will present findings of the audit to the Subcommittee and Caltrans will respond.

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**Staff Recommendation: Informational Item—No Action Required**

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**ISSUE 2: PROPOSITION 1B CAPITAL REQUESTS**

Caltrans will provide an overview of the process by which bond funds are appropriate, programmed, and expended.

**BACKGROUND**

The Governor Budget is requesting a total of \$238.4 million in capital funding for projects in five categories within the Highway Safety, Traffic Reduction, Air Quality and Port Security Bond Act of 2006 (Proposition 1B). This proposal is based on projects in each program for which the project proponent anticipates requesting an allocation of funding during 2013-14. This request is being made to ensure that adequate resources are appropriated to meet the anticipated need during the upcoming year. The Administration intends to update this request in the May Revision to reflect the most recent project information.

While Proposition 1B was approved by voters in 2006, the Legislature must appropriate bond funding to begin the process of allowing a project to move forward. Once funding is appropriated, the California Transportation Commission allocates the appropriated funding to specific projects. With this approval, projects begin to move forward. In many cases, these projects also rely upon matching funds from other sources.

While the appropriation and allocation of funds trigger projects to move forward, the Treasurer and the Department of Finance use actual expenditure expectations to guide the amount of bonds that are sold. This prevents the accumulation of excess cash balances of bond funds, which was a problem in recent years.

**STAFF COMMENT**

While the Subcommittee will not be able to take final action on the proposed Proposition 1B funding level until May, this issue has been included on the agenda to allow the Department to explain the role of the budget appropriation process in the initiation of projects.

In addition, the Subcommittee can revisit an oversight issue from last year regarding unexpended bond funds. Caltrans reports that using improved cash management techniques discussed by the Subcommittee last year, the State was able to reduce its unused bond balance.

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**Staff Recommendation: Hold Open pending May Revision adjustments to bond request.**

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**ISSUE 3: ZERO-BASED BUDGETING LOCAL ASSISTANCE**

The Governor's Budget includes a Zero-Based Budgeting of Caltrans Local Assistance staffing, which results in a downward adjustment.

**BACKGROUND**

As a component of an effort to establish a zero based budget (ZBB) for Caltrans' Division of Local Assistance (DLA), the Governor's Budget has requested a staffing reduction of 23 positions for 2013-14, an additional reduction of two positions for 2014-15, and the exchange of \$13.8 million in federal local subvention funds for State Highway Account funds beyond current levels. Three of the 2013-14 position reductions, as well as the 2014-15 reduction of two positions relate to the proposal to consolidate several existing funding programs into a new Active Transportation Program (ATP), discussed by the Subcommittee at a previous hearing. The proposal includes a request to convert 26 positions that ensure program compliance with state and federal mandates from limited-term to permanent.

The DLA is responsible for the distribution of over a billion dollars of state and federal funds to local and regional agencies. Specifically, DLA assists these agencies in ensuring that funding requirements are met, project applications are processed, and projects are delivered in accordance with federal and state mandates.

In response to Governor's Executive Order (EO) B-13-11 and 2010-11 Supplemental Reporting Language (SRL), the Department of Finance (DOF) initiated a program-by-program ZBB review of Caltrans, beginning with the DLA. The EO requires departments to incorporate program-evaluation methods into the budget process. Such methods may include ZBB, development of performance measures, strategic planning, audits and program reviews. The SRL requires Caltrans, within 180 days of state-level implementation of a new Federal Transportation Act, to develop a baseline view of DLA's workload, including a listing of major activities performed, the level of resources needed to complete each activity, and how the workload aligns with current staffing levels.

**20 positions reduced through Streamlining**

As a result of the Caltrans analysis, efficiencies were identified that enable a reduction of 15 positions across the 12 districts. Efficiencies and streamlining within headquarters have allowed for a reduction of five additional positions. The proposal also notes that the new federal law, Moving Ahead for Progress in the 21<sup>st</sup> Century (MAP-21) has significantly changed the way that federal funding flows to the state and has added flexibility and potential efficiencies to project delivery. Because the Federal Highway Administration (FHWA) has yet to finalize its guidance regarding implementation of the new law, the DLA will monitor changes and request additional resource changes in the future, as needed.

**Active Transportation Program-related staff consolidation**

As noted, the proposal includes a reduction of three positions in 2013-14 and two positions in 2014-15 related to the proposed consolidation of five grant programs into a new ATP. According to the Administration, the reductions would result from the eventual consolidation of the duties of eight existing positions to three positions.

The existing positions proposed for consolidation include the following:

- Safe Routes to School (SR2S) Coordinator
- Assistant SR2S Coordinator
- Bicycle Facilities Program Manager
- Bicycle Transportation Account Program Coordinator
- Environmental Enhancement and Mitigation (EEM) Coordinator
- Transportation Enhancement Coordinator
- District Program Coordinators (two positions allocated across Caltrans' 12 districts).

The new positions proposed to be created include the following:

- ATP Coordinator
- Assistant ATP Coordinator
- District Program Coordinator

Some of the positions proposed for consolidation have existing duties beyond those directly associated with project administration. For example, the Bicycle Program Manager serves as the liaison to the California Bicycle Advisory Committee, a stakeholder group comprised of local officials and advocates. Additionally, federal law requires every state to fund a Bicycle-Pedestrian Coordinator responsible for promoting increased use of non-motorized facilities, as well as public education and safety. Finally, the Department's SR2S Coordinator serves as the liaison to its Safe Routes Advisory Committee, as well as coordinating with entities responsible for technical assistance and research involving best practices for safe routes projects. The Administration indicates that the streamlining efforts associated with the ATP justify the resource reductions and that no adverse impacts have been identified, although duties will be reduced from current levels. It indicates that the Department will continue to assign a person or persons as the bicycle and pedestrian coordinators, but acknowledges that the duties of these positions may be consolidated and include other activities such as ATP coordination. With respect to the SR2S Coordinator, the Administration notes that this position is no longer required under federal law and that, while existing SR2S projects will continue to be supported, the non-ATP related duties of that position will no longer be supported after the proposed consolidation.

**Capture additional federal subvention exchange funding.**

Caltrans' ZBB review also analyzed the department's so-called subvention exchange process. Federal law allows for local subvention funds (federal funds passed through the state to local agencies) to reimburse Caltrans for project support services provided by the DLA on behalf of local agency projects. In the current year, Caltrans has exchanged \$10.0 million of local subvention funds, and as a result of the ZBB analysis, has identified an additional \$13.8 million in services that are eligible for exchange in 2013-14.

**SENATE ACTION**

On March 14, 2013, the Senate Budget Subcommittee 2 took the following action:

- 1) Approve Reduction of 20 Positions Related to Departmental Efficiencies But Not Position Reductions Related to Active Transportation Program and Approve Additional Subvention Exchange.
- 2) Approve Conversion of Limited-Term Positions to Permanent.

**STAFF COMMENT**

The Subcommittee has previously heard testimony regarding the Active Transportation Program. The Subcommittee may wish to defer action on the ATP related reductions pending resolution of the issues related to the proposal itself. It may also wish to seek additional information from the Administration demonstrating how Caltrans' overall efforts to support active transportation would be preserved under this proposal.

While the proposal suggests that the consolidation of five grant programs into one justifies a 62.5 percent reduction in staff resources, a review of the job descriptions of the positions slated for elimination indicates that some include substantial workload beyond grant administration.

For example, the SR2S Coordinator duty statement indicates that at least 45 percent of the workload involves activities such as public awareness, training, interacting with internal and external stakeholders, and outreach to regional, state and national SR2S organizations. This position coordinates the Caltrans SR2S Advisory Committee, which recommends program improvements and best practices. It also serves as Caltrans' point of contact with the Technical Assistance Resource Center (TARC), which was set up by Caltrans in 2008 to support local agencies in developing effective projects. Similarly, at least 55 percent of the Bike Facilities Program Manager's workload appears to involve duties other than administration of the BTA, including bicycle safety awareness, advocacy, training, and support to internal staff and external agencies and providing expertise on bicycle transportation law, policy, and programs. According to the duty statement, this individual serves as Caltrans' expert on bicycle transportation. It should be noted that federal law mandates that every state fund a Bicycle and Pedestrian Coordinator position.

The Administration has acknowledged that, under the proposed consolidation, some of non-grant administration duties of the affected positions would be reduced while others (including the SR2S Coordinator duties) would no longer be supported. This raises questions about the future of TARC, including whether California would remain a national leader on SR2S issues without a state level coordinator. Since the purpose of the ATP proposal is to heighten the profile of active transportation, such substantial reductions may send a confusing message.

Staff recommends that the Subcommittee conform to the Senate action, which would adopt this proposal, but hold open the decision on staff changes related to the Active Transportation Program.

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**Staff Recommendation: Conform to Senate**

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**ISSUE 4: ZERO-BASED BUDGETING PLANNING**

The Governor's Budget proposes an increase of \$8.4 million and 10 positions to address additional workload and implement various efficiency measures.

**BACKGROUND**

The Governor's Budget proposes to Zero Base Budget Caltrans' Division of Transportation Planning. To accomplish this, the Governor, requests a net increase of 10 positions and \$8.4 million, for 2013-14. The proposal consists of a five-position reduction and eight position redirection in the traditional planning program; staff workload adjustments for efficiencies that reduce positions by 19 in planning and increase positions by 36 in the Project Initiation Documents (PIDs) activities to accommodate workload; and, a reduction of two positions in other units. The net result is an increase in the program of 10 positions.

Caltrans' Division of Transportation Planning (DOTP) is responsible for implementing statewide transportation planning. DOTP includes five core programmatic areas: community planning, regional and interregional planning, system and freight planning, state planning and project scoping. DOTP is responsible for a wide variety of activities, including but not limited to review of local and tribal development proposals, general plans, provision of input to federal and regional entities regarding regional transportation plans, review of air quality and climate change scenarios, development of long-range highway system plans, preparation of the 25 year state transportation plan, and development of PIDs for both State Highway Operations and Protection Program (SHOPP) and non-SHOPP projects.

Since 2009, the adequate level of staffing for PIDs has been an ongoing issue of discussion. In 2009, LAO identified that the State was using resources to accumulate a large inventory of project documents that would likely not be used. This led to the formation of a stakeholder group and several initiatives to improve the efficiency of the PIDs. Since that time, Caltrans has made efforts to address the LAO's concerns. It has reduced its inventory of completed PIDs by aligning completed PIDs with updated/revised SHOPP priorities. Caltrans now aligns staffing levels based on PID inventory and identified SHOPP PIDs based on the 10 -Year SHOPP Plan. Caltrans has also undertaken efforts to streamline the development process for certain kinds of PIDs.

The Governor's Budget proposes an increase of 35 positions for SHOPP PID work, driven by the mix of projects in the 2013 10-Year SHOPP plan, and including the work associated with developing PIDs for projects due in the 2014 and 2016 SHOPP programming cycles. The primary reasons for the increase are that: (1) Caltrans no longer maintains a large inventory of completed PIDs, (2) the Department is behind in PIDs development due to a shortfall of personnel dollars, and (3) the mix of projects has shifted compared to prior fiscal years. The proposal also includes a net increase of one position for non-SHOPP PID work. In addition to the positions request, the Governor is seeking an increase in SHA funding to true-up the PIDs personnel dollars. The program is currently experiencing a \$6.2 million shortfall in its 2012-13 base that developed because, while Caltrans had adequate authorized staffing levels to handle ongoing workload, the personnel dollars were inadequate to fully fund those positions at the classifications hired by Caltrans. This proposal would align personnel dollars

with existing classifications in the 2012-13 SHA PIDs program base, and accomplish this using \$2.1 million in savings elsewhere in DOTP and additional an \$4.1 million in SHA funding. The overall ZBB of DOTP would partially offset the increased staffing in the PIDs program through the reduction of 24 positions elsewhere within DOTP. These reductions are the product of aligning staffing with workload, creating efficiencies where feasible and redirecting staff where appropriate. This includes a reduction of one position due to efficiencies created by moving from a one-year to a two-year BCP cycle for the PIDs program. An additional reduction of two positions is to be realized outside of DOTP from efficiencies achieved from the consolidation of the Division of Transportation Systems Information with the Division of Research and Innovation. This proposal results in a requested net increase of 10 positions overall. The Governor's Budget indicates that in an effort to ensure that staff is performing work at the correct classification level; California Department of Human Resources (CalHR) will perform a review of the division to ensure consistency in compliance with state staffing requirements.

#### LAO RECOMMENDATION

The LAO found that the narrative in the Caltrans budget change proposal was not consistent with the backup documents that supported the budget request. The LAO published a recommendation to reduce the proposal by \$2.9 million and 21 positions to reflect the lower workload needs articulated in its reading of the narrative, which described new streamline PID documents.

The LAO further recommended the Caltrans report on the workload needs of certain project documents.

#### STAFF COMMENT

At the request of Senate Budget Subcommittee 2, Caltrans and LAO staff met to discuss the LAO recommendations. Caltrans stated that it believes the description in the narrative of this budget request was being misinterpreted by LAO and that the backup data that justified the positions should be used to determine the staffing needs for this local planning. Caltrans also agreed to report to LAO actual workload levels for PID preparation.

Staff recommends that the Subcommittee approve the Caltrans proposal as budgeted. This budget request was a result of an exhaustive review of the resource needs through a Zero-Based Budgeting methodology, which found that resources were insufficient.

However, LAO is correct in noting that the actual needs for future streamlined documents are unknown and should be monitored. Therefore, staff recommends adoption of Supplemental Reporting Language so that the resources needs of PIDs can be monitored and oversight of these positions can continue.

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**Staff Recommendation: Approve as Budgeted with Supplemental Report Language.**

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**ISSUE 5: CASH MANAGEMENT TRAILER BILL LANGUAGE**

The Governor's Budget includes trailer bill language to clarify the cash-reporting for various transportation special funds

**BACKGROUND**

The Governor's Budget proposes technical trailer bill language to clarify that, with respect to five specified funds—the Public Transportation Account (PTA), State Highway Account (SHA), Transportation Investment Fund (TIF), Transportation Deferred Investment Fund (TDIF), and the Traffic Congestion Relief Fund (TCRF)—the Department may use cash accounting procedures in reporting the fund balances to the State Controller and for budget purposes.

This proposal further clarifies current law, which intended to account for these special funds using cash accounting procedures.

**STAFF COMMENT**

This technical trailer bill provision reflects legislative intent and staff recommends approval.

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**Staff Recommendation: Adopt placeholder Trailer Bill Language**

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**ISSUE 6: INDIRECT COST ALLOCATION PLANS AUDITS**

The Governor's Budget includes a proposal to make eight temporary positions that audit cost-allocation plans permanent.

**BACKGROUND**

The Governor's Budget requests a conversion of eight limited-term positions to permanent and to exchange \$1.9 million in local federal subvention funds for an equivalent amount of State Highway Account Funds. These positions were originally approved in fiscal year 2009-10 and approved for a two-year extension in 2011-12.

Caltrans has a legal and fiduciary duty to ensure that all state and federal funds are expended in compliance with applicable laws, regulations, and agreements. This includes an average of \$1.3 billion in federal and state funds expended annually by local government agencies (LGA) within the state. Improper reimbursement of LGAs can have significant consequences, particularly when federal funds are involved. If FHWA determines that reimbursements have occurred in error or for unallowable expenditures, Caltrans must reimburse these costs and seek reimbursement from the LGA. Improper reimbursement reduces the funding available for eligible project costs.

**STAFF COMMENT**

The positions were approved in 2009 as limited-term because at the time it was unknown if increased audit workload would be permanent. The proposal seeks to convert eight of the positions to permanent status because it is apparent that the increased workload will be ongoing. According to the proposal, the limited duration of the positions has made them difficult to fill and has contributed to a high level of turnover. Under the law, an employee may not serve in a limited-term position for more than 24 months, and subsequently may not be rehired for an extended term, making it difficult for Caltrans to attract and retain qualified staff.

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**Staff Recommendation: Approve as Budgeted**

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**2665 HIGH SPEED RAIL AUTHORITY**

**ISSUE 1: OVERVIEW OF HIGH SPEED RAIL**

The Subcommittee will receive an update from the High Speed Rail System.

**BACKGROUND**

The California High-Speed Rail Authority's mission is to plan, design, build, and operate a high-speed train system for California. The High-Speed Rail Authority is responsible for the development and construction of a high-speed passenger train service between San Francisco and Los Angeles/Anaheim (Phase I), with extensions to San Diego and Sacramento and points in-between (Phase II). Proposition 1A, enacted in November 2008, authorizes \$9 billion in bond proceeds for the rail lines and equipment, and an additional \$950 million for state and local feeder lines. The federal government has also awarded the Authority nearly \$3.5 billion, most of which has been designated to fund portions of the project in the Central Valley.

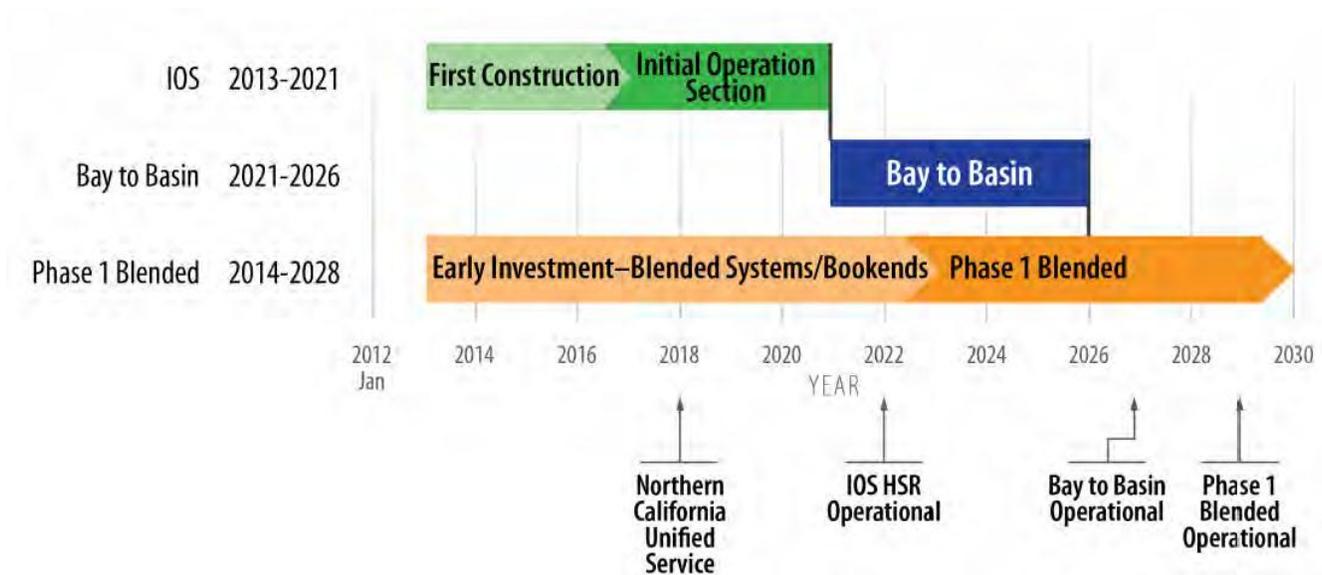
**April 2012 Revised Business Plan**

On April 2, 2012, the High-Speed Rail Authority issued a Revised Business Plan that articulated the current project approach for the High-Speed Rail system. The report estimated that it would take until 2028 and cost approximately \$68 billion to allow for a one-seat High-Speed Rail ride from San Francisco to Los Angeles.

The map below, prepared by HSRA, illustrates High Speed Rail Route and current “blended” partnerships:



The chart below, prepared by the Authority, provides an overview of the construction timeline:



The Business Plan identifies three phases for the project:

1. **Initial Operating Segment**— 300-mile segment from Merced to the San Fernando Valley. The plan envisions that High-Speed Rail Service begins on this segment in 2022 and that it would include connections with regional/local rail for blended operations, so riders could transfer to other rail systems. The business plan also identifies closing the rail gap between the Bakersfield and LA Basin as a priority for this phase. The Authority reports that it will accelerate environmental review work on that gap.
2. **Bay to Basin**— 410 miles of High-Speed Rail service from the San Jose to the San Fernando Valley, expected to beginning in 2026.
3. **Phase 1 Blended**— 520 miles of service that allows a one-seat ride from San Francisco's Transbay Terminal to downtown Los Angeles that would begin in 2028. While this is the last Phase of the project to be completed, the revised business plan begins making investments in "blended" activities in the near term, as these investments result in immediate benefits for users of existing regional and commuter rail systems.

The Business plan also mentions Phase 2 of the project, which would provide 800 miles of services that would include San Diego and Sacramento, as well as linking to several existing rail systems this would occur after Phase 1 is completed.

The Revised Business Plan reflects the "Blended Approach" for final build out, which means that High-Speed Rail will use existing regional and commuter rail lines in urban and metropolitan areas for service, rather than building dedicated rail lines. This significantly reduces the costs of the project and shortens the project completion time. The project also invests High Speed Rail bond funding into improvements to the "bookends," existing rail in the Bay Area and Los Angeles, which allows existing rail users to see the benefits of High-Speed Rail investment in the near future.

<b>STAFF COMMENTS</b>
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The Authority will provide an update and overview of the project.

The Subcommittee may wish to ask the Authority to provide more information on the following issues, which have been the result of recent press coverage.

### **Planning Contract Increases**

The Authority has provided the Subcommittee with a letter, dated April 5, 2013, which disputes recent press accounts that suggest that the planning costs for the project are exceeding their budget. The Authority's letter indicates that recent High Speed Rail Board action to amend environmental review and planning contracts for the "Fresno to Bakersfield" and "San Jose to Merced" segments were in line with the projections contained in the 2012 Business Plan adopted by the Board in March 2012.

### **Validation Action**

The Authority is also attempting to eliminate any question as to whether Proposition 1A High Speed Bond Act funds can be used for the existing business plan by pursuing a validation action in the courts. On March 28, 2013, the San Jose Mercury News published an article by Mike Rosenberg entitled "*California's High-Speed Rail Authority sues everybody, invites you to argue case in court*" which described this action by the Authority. The Subcommittee may wish to ask the Authority for clarification regarding their validation action.

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**Staff Recommendation: Informational Item—No Action Recommended**

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**ISSUE 2: GOVERNOR'S BUDGET PROPOSALS FOR HIGH SPEED RAIL**

The Subcommittee will discuss the High Speed Rail funding requests for this year.

**BACKGROUND**

The 2012 Budget Act appropriated approximately \$8 billion for the high-speed rail project for the following purposes:

- \$5.8 billion for the first phase of the Initial Operating Section from Madera to Bakersfield.
- \$1.1 billion for early improvement “bookend” projects to upgrade existing rail lines in Northern and Southern California, which will lay the foundation for future high-speed rail service as it expands into these areas.
- \$819.3 million for connectivity projects to enhance local transit and intercity rail systems that will ultimately link to the future high-speed rail system.

Since the funding for planning and construction have already been appropriated in 2012, the Governor’s 2013-14 budget proposals focus on requests to increase and maintain the existing administration structure of the Authority. However, the 2012 budget provided extensive reporting requirements that will allow the Assembly to conduct oversight on the project this year. The chart below illustrates the expected expenditures for the High-Speed Rail Authority.

Fund Source	2011-12 Actual	2012-13 Estimated	2013-14 Proposed	BY to CY Change	% Change
General Fund	\$0	\$0	\$0	0	0
Federal Trust Funds	0	660	18	(642)	(97.3)
Prop 1A Bond Funds	14,719	23,818	121,106	97,288	408.5
<b>Total Expenditure</b>	<b>\$14,719</b>	<b>\$24,478</b>	<b>\$121,124</b>	<b>96,646</b>	<b>394.8</b>
Positions	32.4	71.5	86	14.5	20.2

The Governor's Budget includes four BCPs for a total of \$9.97 million and 20 positions to increase staffing, combined with proposals to continue funding for outreach, project management, and financial contracts. With these additional positions, the High-Speed Rail System will continue to grow as the project rolls out. These January Budget proposals are:

1. **Additional State Staff.** \$1.6 million in Proposition 1A funds to fund 20 new permanent positions at HSRA to provide information technology (IT), contract management, and transportation planning functions.
2. **Program Management Oversight Contract.** \$4.1 million in Proposition 1A funds to contract for program management oversight, which provides engineering consulting services to HSRA executive management. This is a reduction of \$900,000 compared to the current-year level of funding. The budget also proposes budget bill language that would allow HSRA to administratively establish new permanent oversight positions when it determines that it can take on some or all of the responsibilities of the private contractor.
3. **Financial Oversight Services.** \$3.8 million in Proposition 1A funds to contract for financial services consulting, which is an increase of about \$1.3 million from the current-year level of funding.
4. **Outreach.** \$500,000 in Proposition 1A funds for public outreach services.

#### APRIL 1 FISCAL LETTERS

The Department of Finance submitted four proposals as part of an April 1 Spring Fiscal Letter. These proposals are:

1. **One-time Loan of Public Transportation Account funds to cover State Operations.** The Authority requests budget provisional language to allow for a one-time loan of \$26.2 million to the High Speed Rail Bond fund from the Public Transportation Account for the Authority's operating costs. The loan provides an alternative funding source for the Authority's support costs as the Authority seeks a validation action to affirm that the overall project is consistent with the funding requirements of the Proposition 1A bond act.
2. **Conversion of Project Deliver Functions to State Staff.** The Spring Fiscal Letter requests \$265,000 and 41 positions to bring project management and oversight activities in-house. This request also includes provisional language to allow optional reimbursement to the authority and Caltrans to allow the Authority to use State staff for planning.
3. **Increased Administrative Staff.** The Authority is requesting \$4.8 million and 44 positions for administrative support work associated with the ramp-up of the authority as project construction begins.

4. **Trailer Bill Language on Utility Relocation.** The Authority is requesting statutory language to establish a process and rules for the relocations of utilities outside the right-of-way for the High Speed Rail project. The language is modeled after procedures already in place for Caltrans projects.

#### LAO CONCERNS

LAO has two recommendations related to the Governor's January Budget request:

1. Approve funding for external professional services, but reject budget bill language that would allow the High Speed Rail Authority to administratively establish an unspecified number of additional permanent positions. This language would not allow for appropriate legislative oversight of the establishment of new permanent state positions.
2. Reduce funding for financial services by \$1.25 million in Proposition 1A bond funds because some of the identified tasks would be more appropriate for, and less costly if performed by, existing state staff.

#### STAFF COMMENTS

The Governor's Budget includes four BCPs for a total of \$9.97 million and 20 positions to increase staffing, combined with proposals to continue funding for outreach, project management, and financial contracts. The recent Spring Fiscal letters add an additional 85 positions. With these additional positions, the High-Speed Rail System will continue to grow as the project rolls out.

In its Spring Fiscal letter, the Authority is addressing the concern that too much project oversight was in the hands of contractors. In a January 2012 report by the Bureau of State Audits, the Auditor raised this as a concern. Among the findings of that report:

- The Authority is significantly understaffed and has struggled to oversee its contractors and subcontractors, who outnumber its employees by about 25 to one.
- The Authority may have compromised providing effective oversight by placing the largest portion of the program's planning, construction, and oversight in the hands of contractors—in particular, the entity that manages the program (Program Manager).
- By relinquishing significant control to the Program Manager, the Authority may not be aware of or have addressed areas of significant concern that could impact the program.
- Similar to our prior audit, we found over 50 errors and inconsistencies of various types in three Program Manager's monthly progress reports we reviewed and noted several significant discrepancies between the regional contractors' reports and those of the Program Manager

The additional staffing proposed for the Authority at this early stage of the project is essential to ensure that the State interests are protected with sufficient staffing to oversee what will be the largest infrastructure project in the United States.

### Funding Structure May Benefit from Further Refinement

Last year, the Administration explored simplifying the planning and acquisition budgeting for High-Speed Rail to give the project more flexibility to use funding efficiently. Funding to date has been appropriated annually by project segment. The Administration has reported that in some cases the project has had to slow work in one segment because it lacked the ability to move funding between segments and that annual appropriate process leads to delays. The Assembly may wish to consider if there is an alternative budgeting structure that provides the transparency and oversight of the current structure but gives the Administration more flexibility to administer the funding.

### **Staff Recommendation**

Staff recommends the following action regarding High Speed Rail's budget provisions:

- 1. Adopt LAO Recommendation regarding Budget Bill Provisional Language** The LAO recommends that the Subcommittee reject budget bill language that would allow the High Speed Rail Authority to administratively establish an unspecified number of additional permanent positions. With the submission of the Spring Fiscal Letter, the Authority will not need this authority and concurs with LAO's recommendation.
- 2. Approve Fiscal Oversight Contract** Staff recommends that the Subcommittee adopt the full \$3.8 million for the Fiscal Oversight Contract. The LAO recommend the Subcommittee reduce this amount by \$1.25 million in Proposition 1A bond funds because some of the identified tasks would be more appropriate for, and less costly if performed by, existing state staff. The Authority has responded that it does not believe its in-house staff can substitute for the outside expertise and advice offered by the contractor.
- 3. Hold Open Spring Fiscal Letter Trailer Bill Provision.** Staff has no concerns with the proposal conceptually but lacks the expertise to evaluate whether the proposed trailer bill is consistent with the approach put forward by Caltrans. Thus, staff recommends the Subcommittee hold open this item until May so that the staff may validate High Speed Rail's approach.
- 4. Approve remaining Spring Fiscal Letter and Governor's Budget Proposals.** Staff recommends approving the remaining requests.

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**Staff Recommendation: Adopt Staff Recommendation**

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**2740 DEPARTMENT OF MOTOR VEHICLES****ISSUE 1: DMV BUDGET PROPOSALS**

The Subcommittee will hear and overview of the Department of Motor Vehicles and consider various budget proposals.

**BACKGROUND**

The Department of Motor Vehicles (DMV) promotes driver safety by licensing drivers, and protects consumers and ownership security by issuing vehicle titles and regulating vehicle sales. The DMV also collects the various fees that are revenues to the Motor Vehicle Account. The Department is currently reviewing its methods of providing services to the public and developing alternatives to visiting the field offices.

The Governor's Budget proposes \$991.5 million, (Special Funds), an increase of \$39.6 million from the revised current year budget. The budget also includes a reduction of 30 positions.

Fund Source	2011-12 Actual	2012-13 Estimated	2013-14 Proposed	BY to CY Change	% Change
General Fund	\$1	\$0	\$0	0	0
State Highway Account, State Transportation Fund	\$46,355	\$49,036	\$9,159	(\$39,877)	(81.3)
Motor Vehicle Account, State Transportation Fund	804,783	858,259	939,971	\$81,712	9.5
Motor Vehicle License Fee Account, Transportation Tax Fund	24,911	18,200	16,716	(1,484)	(8.2)
Other Special Funds	2,457	7,482	6,130	1,692	38.1
Federal Trust Fund	2,457	7,482	5,129	(2,353)	(31.4)
Reimbursements	14,702	14,408	14,408	\$0	0
<b>Total Expenditure</b>	<b>\$899,291</b>	<b>\$951,823</b>	<b>\$991,513</b>	<b>\$39,690</b>	<b>4.2</b>
<b>Positions</b>	<b>8,287.5</b>	<b>8,239.3</b>	<b>8,209.3</b>	<b>(30)</b>	<b>(0.4)</b>

The Department has two budget proposals in the Governor's Budget:

- **Grass Valley Field Office.** The DMV has a Capital Outlay request for \$6.5 million to begin construction of a 7,583 square foot field office building in Grass Valley. This facility would replace the current 1,998 square foot facility that was formerly a California Highway Patrol building. The Assembly has previously approved funding for planning documents for this project in the 2012-13 budget.
- **Implementation of SB 1298 (Padilla).** The Governor's Budget includes \$980,000 and two limited-term positions for the implementation of SB 1298 (Padilla), Chapter 570 Statutes of 2012, which allows for the testing of autonomous vehicles. The bill requires DMV to adopt regulations to specify insurance requirements, testing, equipment, and performance standards for the safe operation of autonomous vehicles.

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**Staff Recommendation: Approve as Budgeted**

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**ISSUE 2: INFORMATION TECHNOLOGY MODERNIZATION PROJECT**

The Subcommittee will discuss the termination of the Information Technology Modernization Project by the California Technology Agency.

**BACKGROUND**

On January 31, 2013, the California Technology Agency (CTA) terminated the Information Technology Modernization (ITM) Project. The multi-phase project was partially implemented.

In 2005, the DMV sponsored the Information ITM Project, an effort to modernize the DMV's core driver license and vehicle registration system, which is responsible for licensing 26 million drivers and registering 31 million vehicles while collecting \$6.8 billion in fees annually. According to DMV, the current system, commonly referred to as the legacy system, is dependent on 40-year old technology which is inflexible and fragmented leading to significant challenges in implementing state and federal mandates and policy changes. The ITM project intended to replace the legacy system with sustainable, scalable, and readily supported technologies. In 2006, the Legislature approved the project with an estimated total cost of \$242 million and with full implementation scheduled for May 2013.

The ITM Project intended to incrementally upgrade the DMV's core system using a series of independent subprojects. The four subprojects sought to (1) update DMV's database, (2) update DMV's transaction management system, (3) build new web-based driver license and vehicle registration systems, and (4) update DMV's code written in a now-obsolete programming language. The subprojects were designed to build on one another while allowing the state to realize tangible benefits throughout the duration of the project. Two of the four ITM subprojects are complete, including an upgrade to DMV's driver licensing system. The remaining two subprojects were in progress at the time of the overall project's termination.

In 2007, DMV awarded a \$76 million contract to Electronic Data Systems (EDS) to update the state's driver license and vehicle registration systems. EDS was purchased by Hewlett-Packard Enterprise Services (HPES) in 2008. As of the date of this analysis, \$50 million of the \$76 million contract has been paid to HPES for work on the four subprojects, including the completed upgrade of the driver license system.

The project updated the cost and modified the schedule through a Special Project Report (SPR) in September 2008. Updated information received through planning reduced total project cost by a net of \$34 million to \$208 million. (The project's development, conversion, and consulting services cost categories were reduced by \$50 million. Updated cost estimates for other categories increased, resulting in an overall reduction in cost by \$34 million from the previously approved \$242 million). Although the planning and procurement phases took five months longer than expected, the SPR modified the schedule to start project tasks sooner and in parallel so that the full implementation would remain as previously scheduled for May 2013.

Over the last year, DMV worked to complete the project on schedule. Disagreement arose between the department and HPES regarding the quantity of vendor staff necessary, and their required experience, to effectively manage the workload and maintain the project on schedule. According to DMV, the disagreements seriously and negatively impacted the project schedule. Given the project's trajectory during the first half of 2012, it became evident to DMV that the May 2013 completion date was not achievable. The department entered into a discussion with HPES to establish a plan for resetting the project's trajectory towards a successful completion. The major concerns of DMV were documented in a cure notice, discussed below.

On May 7, 2012, DMV issued a cure notice to the primary vendor, HPES, expressing serious concern regarding HPES's ability to successfully complete the project. According to DMV, HPES failed to provide acceptable and timely work products and was in breach of contract. The DMV specifically raised concern regarding the: (1) lack of key vendor staff and inadequate staff experience; (2) vehicle registration replacement system delays and lack of schedule; and, (3) programming language replacement delays and lack of schedule. The notice prompted HPES to provide its remedial strategy by May 23, 2012, so that the project could move forward.

The HPES submitted a response to the cure notice as required on May 23, 2012. In its response, HPES acknowledged the need to address the issues raised by DMV, offered a description of the actions it would take to resolve DMV's concerns, and provided a series of recommendations intended to enhance the prospect of successfully completing the project. The DMV and HPES attempted to work towards a mutual agreement for resolving the issues raised by DMV in the cure notice. After eight months of discussion, DMV and HPES had not reached a mutual agreement regarding the cure notice issues, mainly (1) the timeframe for completing the remaining subprojects and (2) the personnel needed and their required level of expertise.

On January 31, 2013, the California Technology Agency (CTA) terminated the ITM Project pursuant to its authority under Government Code Section 11546, with direction to complete a component of the project that was nearly finished. According to CTA, it had watched for months as DMV and HPES worked towards an agreement on a path forward for the project and remained concerned regarding their lack of progress. The letter notifying DMV of the project's termination directed the project to immediately suspend all work related to the vehicle registration component of the ITM Project (minimal work had been completed on this component of the project). The CTA also directed DMV to complete the driver license component of the project. At the time of the termination, the driver license upgrade had been implemented in all 170 field offices and call centers. However, deployment of the new driver license system to DMV Headquarters had begun, but was not yet complete.

On February 25, 2013, DMV signed a contract amendment with HPSE to reduce the scope of work and shorten the duration of the project. As part of the contract amendment, DMV and HPES agreed to a closure plan to complete final activities associated with the upgrade of the driver license system by March 31, 2013. HPES also agreed to provide DMV documentation to assist with the state's management of this system. Finally, HPES agreed to pay DMV \$1 million. (The vendor agreed to refund the state \$2.5 million for work that was complete

and paid for but no longer usable by the DMV given the termination of the project, while the state had an outstanding balance of \$1.5 million owed to HPES for various services delivered by HPES, resulting in the net payment to DMV of \$1 million.)

As of January 2013, a total of \$135 million has been spent on the project including: (1) \$50 million paid to HPES for work on updating the driver license system; (2) \$15 million paid to various other contractors for services including project oversight; (3) \$18 million spent on DMV staff working on the project; and, (4) \$32 million spent on data center services, including data storage.

The DMV and CTA are collaborating to determine the best way to complete the remaining parts of the ITM Project, including the upgrade to the state's vehicle registration system. According to DMV, it intends to work with CTA and an independent contractor to: (1) assess the challenges of the ITM Project; and, (2) document possible lessons, before a proposal to complete the remaining components of the project is developed. A timeline for completing this analysis is unknown, but DMV indicates it prefers a thorough evaluation rather than moving forward with a new proposal to complete the vehicle registration and other project components prematurely.

As the project is terminated, no budget proposal is expected in 2013-14. The 25 personnel currently serving the project are limited-term positions and set to expire on June 30, 2013. Personnel positions will not be allocated towards the project in the 2013-14 fiscal year. The appropriation for fiscal year 2012-13 is \$16 million. Actual expenditures in 2012-13 to date cover activities in the areas of software customization, project readiness, project management assistance, project oversight support, and IT support costs. At the time of this analysis, the DMV projected that \$11 million of the current-year allocation will remain unspent due to project termination and reflect as savings at the end of the fiscal year.

#### LAO RECOMMENDATIONS

The LAO offered the following analysis of the termination of the ITM system:

***Legacy System Only Alternative in the Near Term.*** Although the state's legacy DMV systems lack a central architecture, including consistent data methodology and programming languages, they have been running the DMV's business processes for decades. In general, the legacy systems—though outdated, inflexible, fragmented, and difficult to upgrade—seem a credible (and, in practice, the only) alternative for the state to use over the next few years. Given the availability of these still-functioning legacy systems, we suggest that the Legislature prioritize thoroughness over timeliness as it evaluates the shortcomings of the ITM Project and considers new alternatives for replacing California's legacy vehicle registration systems.

**Updating the State's Vehicle Registration System Still Worthwhile.** As the vehicle registration system is a critical component of the state's traffic safety and revenue collection, investing to ensure accurate and timely management of vehicle registration activities is a worthwhile endeavor. The termination of the ITM Project means that the state's need for updating DMV's core vehicle registration system remains unmet. There are numerous functionality, and stability issues that justify the continued pursuit of an updated vehicle registration configuration. According to DMV, updating the vehicle registration systems in response to changes in state or federal law has become extremely challenging given the outdated and inflexible legacy technology resulting in longer time frames and thus increased costs.

In addition, the maintenance of the legacy vehicle registration system will remain dependent on state staff that have experience with the existing system. Staff resources with the necessary legacy technical skills, including knowledge of obsolete and no longer taught programming languages, will continue to diminish over time due to retirements. This will likely cause delays to enhancements of the legacy system and may create a higher risk with any future project upgrading the legacy system. Updating the state's vehicle registration systems would also likely facilitate DMV's compliance with state and federal laws and reduce the likelihood of significant disruptions in future years.

**Legislature Will Likely Face a Difficult Decision.** After the termination of the project's contract with its primary vendor, the state has spent roughly \$135 million on the ITM Project with several tangible deliverables, including an upgraded driver license system. As mentioned previously, the DMV intends to work with the CTA and an independent contractor to assess: (1) the challenges of the ITM Project; and, (2) document possible lessons learned, before developing a proposal to complete the remaining components of the project. At the time the Legislature receives this proposal, it will likely face a difficult decision concerning the remaining components of the project, notably the vehicle registration component. While continuing the modernization project is likely necessary at some point, the Legislature may decide that with the state's fiscal constraints, the project should be delayed and state resources appropriated for higher legislative priorities. The Legislature, on the other hand, may consider that issues such as the shrinking pool of staff resources with the technical skills necessary to maintain and upgrade the current legacy system warrant continuing the modernization project sooner rather than later.

**Questions to Ask DMV.** As the Legislature awaits the project assessment described above and begins to deliberate how to move forward, there are questions the Legislature may wish to ask DMV at budget hearings.

- Can you provide more detail on the process you will use to assess the challenges of the ITM project to this point and possible lessons learned? What specific issues will the assessment consider?
- Can you provide a timeline of when the assessment will begin and be completed?

**STAFF COMMENT**

It is frankly refreshing to see the California Technology Agency take a pro-active role in ending contracts where the vendors do not appear to be addressing State concerns. CTA terminated two separate contracts on January 31, 2013, and it was the first time the State had been so aggressive in holding our vendors accountable. DMV appears to have been very careful about monitoring this project and setting clear expectations for deliverables, and took appropriate steps when the vendor was out of compliance. While this resulted in the end of the project mid-stream, that outcome is preferable to the State accepting and paying for a shoddy system that would not have worked well for the public. Staff believes this outcome demonstrates DMV's effective oversight of this complicated project and overall strong administrative competency.

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**Staff Recommendation: Informational Item—No Action Recommended**

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