

AGENDA**ASSEMBLY BUDGET SUBCOMMITTEE NO. 4
ON STATE ADMINISTRATION**

Assembly Member Joan Buchanan, Chair

THURSDAY, MAY 26, 2011
STATE CAPITOL, ROOM 447
1:30 P.M.**CONSENT CALENDAR**

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CONSENT ITEMS**ITEM 0840 STATE CONTROLLER'S OFFICE****ISSUE 1: TRANSPORTATION AUDITS—INDIRECT COST ALLOCATION PLANS**

At the May 3rd hearing, the Subcommittee approved funding for audit services of local governments' indirect cost allocation plans pursuant to an interagency agreement with the Department of Transportation (Caltrans). The audit services are provided in order to receive continued transportation funding from the federal government. The Senate subcommittee approved this request along with placeholder Supplemental Report Language (SRL) regarding the necessity of continuing the two-year, limited-term positions into the second year, given the prospect that the federal government may act to reduce audit presence requirements under their funding programs. By adopting the SRL, this action would conform to the Senate action. The proposed SRL is:

Item 0840

The State Controller's Office shall report to the Legislature By March 1, 2012 on the necessity of continuing for fiscal year 2012-13, 12.6 limited-term audit positions to provide audit services for indirect cost allocation plans for local government agencies pursuant to a request by the California Department of Transportation. The report to the Legislature shall include but not be limited to: (1) comparison of 2011-12 estimated workload and actual workload to date of the positions; (2) analysis of any changes in federal audit requirements for the receipt of federal funds that could affect workload in 2012-13; (3) estimated workload for the positions in 2012-13. The report shall be provided to the fiscal committees of the Legislature, the Department of Finance and the Legislative Analyst's Office.

Staff Recommendation: Adopt Supplemental Report Language.

ITEM 1920 CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM**ISSUE 1: REVISED CREDITABLE COMPENSATION**

This May Revision proposal constitutes a technical correction regarding the amount of General Fund contribution to CalSTRs based on a revision of creditable compensation as reported for 2009-10. The true-up is a percentage-driven calculation and is the result of a lag in reporting of actual compensation. The Governor's Budget estimated 2011-12 contributions of \$1.35 billion, based on October 2010 report of prior-year teacher payroll by CalSTRs. The actual amount is based on the submission by CalSTRs in April 2011 of an update to the prior-year teacher payroll.

The revision in the creditable compensation results in an increase in funding of \$1,375,000. This increase consists of \$565,000 in the defined benefit level, \$110,000 in the pre-1990 defined benefit level, and \$700,000 for supplemental benefit maintenance account.

Staff has no issues with this proposal.

Staff Recommendation: Adopt May Revision request.

ITEM CS 3.60 CONTRIBUTIONS TO PUBLIC EMPLOYEES' RETIREMENT**ISSUE 1: INVESTMENT AND RETIREMENT RATE ADJUSTMENTS**

The May Revision calls for Control Section 3.60 to be decreased to account for adjustments in the investment rates and retirement rates. The Governor's Budget made assumptions regarding investment rates of return as well as retirement rates that have since been revisited and revised. Specifically, adjustments made are:

- **Investment Rates.** These were assumed to decrease from 7.75 percent to 7.50 percent in January, but the CalPERs Board retained the rate at 7.75 percent resulting in General Fund savings of \$200 million, along with savings in special funds and various other non-governmental cost funds.
- **Retirement Rates.** Employee retirement rates are below those assumed earlier in the year and result in a decline in required General Fund support and resulting savings of \$86.6 million General Fund, and additional savings in special funds and other nongovernmental cost funds.

These adjustments are not final and could change pending the adoption of the final 2011-12 retirement rates by the CaPERs Board. As a result of the total \$286.6 million General Fund adjustment, the fourth quarter payment to CalPERs (which was deferred to 2012-13) will decrease by \$71.7 million. Thus, the total net savings for 2011-12 will be the \$286.6 million less the \$71.7 million for a net savings of \$215.0 million. Technical language adjustments would also be made in the control sections.

Staff has no issues with this proposal.

Staff Recommendation: Adopt May Revision request.

ITEM CS 3.90 REDUCTION FOR EMPLOYEE COMPENSATION**ISSUE 1: ELIMINATION OF DEFINED CONTRIBUTION PLAN**

The May Revision calls for an increase in the employee compensation reductions due to changes in employee compensation, resulting in a savings of \$9.7 million. Under this revision, departmental budgets will be reduced as a result of the elimination of the Peace Officers' and Firefighters' Defined Contribution Plan (PO/FF II) retirement benefit for supervisors and managers, affiliated with bargaining Unit 6 (California Correctional Peace Officers Association). PO/FF II is an employer-funded benefit that supplements these employees' CalPERs pension benefits. The state contributed 2 percent of base pay for each employee with no employee contribution. This request includes the technical language adjustment to the control section to account for employees no longer receiving this retirement benefit. Staff has no concerns with this proposal.

Staff Recommendation: Adopt May Revision request.

ITEM 9620 CASH MANAGEMENT AND BUDGETARY LOANS**ISSUE 1: INTEREST ON CASH FLOW BORROWING**

Due to a decrease in interest costs related to internal borrowing, the May Revision includes a request to reduce the budgeted amount for interest costs associated with these loans. Interest cost associated with internal borrowing will be reduced from \$100 million in the Governor's Budget to \$75 million for 2011-12. In addition, the borrowing costs during the current year have also declined by \$25 million, for a total two-year reduction in interest costs on internal borrowing of \$50 million.

Staff has no concerns with this request.

Staff Recommendation: Adopt May Revision request.

ITEM CS 4.30 AND 9966 LEASE REVENUE BOND DEBT SERVICE**ISSUE 1: DECREASE IN DEBT SERVICE PAYMENTS**

The May Revision calls for a reduction in debt service payments for fiscal year 2011-12. The total of these changes is a General Fund reduction of \$471,000 and a reduction of \$4.0 million in other funds. The decrease in the budgeted amount is a result of the update in the estimates of the timing of the bond sales. Approval will allow for the issuance of an executive order to allocate the adjustments among the various funds.

Staff has no concerns with this proposal.

Staff Recommendation: Adopt May Revision request.

ITEM CS 12.00 STATE APPROPRIATIONS LIMIT**ISSUE 1: REVISION TO APPROPRIATION LIMIT**

The May Revision requests that the state appropriation limit pursuant to Article XIII B of the California Constitution be adjusted as a result of applying the growth factor of 3.07 percent. The revised limit of \$81.468 billion is \$314 million below the estimate of \$81.799 billion in the January Budget.

Staff has no concerns with this proposal.

Staff Recommendation: Adopt May Revision request.

1760 DEPARTMENT OF GENERAL SERVICES**ISSUE 1: CAPITAL OUTLAY REAPPROPRIATIONS**

The Department of Finance has issued an April letter that proposes the following reappropriations of previously approved funding:

- 1) \$5,951,000 for working drawing and construction phases of the structural retrofit project for the Walker Clinic and infirmary Buildings at the California institution for Women (CIW) in Corona, Riverside County;
- 2) Proposes an extension of 437,000 to the encumbrance and expenditure period for the construction funds for renovation of Office Building 10 in Sacramento; and,
- 3) Proposes an extension of the liquidation of \$851,000 for the construction phase of the Marysville Office Replacement project.

STAFF COMMENT

All projects requesting reappropriation were previously suspended by the Pooled Money investment Board's decision to freeze all disbursements from AB 55 loans. All state entities that had expenditure control and oversight of General Obligation and lease revenue bond programs were ceased. In order to complete these projects, funding must be reappropriated.

Consent Action: Adopt April Finance Letter**ITEM 8830 CALIFORNIA LAW REVISION COMMISSION****ISSUE 1: ELIMINATION OF THE LAW REVISION COMMISSION**

The Governor's May Revision proposes a reduction of \$333,000 (\$325,000 General Fund) resulting from the elimination of the California Law Revision Commission.

BACKGROUND

The Law Revision Commission is responsible for reviewing California law, recommending legislation to make needed reforms, and making recommendations to the Governor and Legislature for revision of the law on major topics. For the current budget year, the Law Revision Commission is fully supported by reimbursements from the Legislative Counsel Bureau's budget. Staff recommends that this funding approach be continued for the 2011-12 fiscal year by adopting the following budget bill language:

For the 2011-12 fiscal year only, the reimbursements identified in Schedule (2), the amount of \$650,000 shall be paid from the amounts appropriated in Items 0160-001-0001 and 0160-001-9740.

Consent Action: Approve Provisional Language to pay the reimbursements in the Law Revision Commission's budget from the Legislative Counsel Bureau's budget.

ITEM 8840 COMMISSION ON UNIFORM STATE LAWS**ISSUE 1: ELIMINATION OF THE COMMISSION ON UNIFORM STATE LAWS**

The Governor's May Revision proposes a reduction of \$74,000 General Fund resulting from the elimination of the Commission on Uniform State Laws.

BACKGROUND

The Commission on Uniform State Laws presents to the Legislature uniform laws recommended by the National Conference of Commissioners on Uniform State Laws and promotes the passage of these uniform acts. For the current budget year, the Commission on Uniform State Laws is fully supported by reimbursements from the Legislative Counsel Bureau's budget. Staff recommends that this funding approach be continued for the 2011-12 fiscal year by adopting the following budget bill language:

For the 2011-12 fiscal year only, the reimbursements identified in Schedule (2) shall be paid from the amounts appropriated in Items 0160-001-0001 and 0160-001-9740.

Consent Action: Approve Provisional Language to pay the reimbursements in the Commission on Uniform State Law's budget from the Legislative Counsel Bureau's budget.

VOTE ONLY**ITEM 0950 STATE TREASURER'S OFFICE****ISSUE 1: BUDGET BILL LANGUAGE FOR BOND SALE EXPENSES**

The State Treasurer's Office (STO) has requested Budget Bill Language (BBL) to allow for the Department of Finance (DOF) to authorize expenditure of up to \$800,000 in excess of the amount appropriated for various bond issuance costs, in the event the issuance of the bonds is cancelled. The fiscal committees of the Legislature would also be provided 30 days' notice in the event DOF approves the request. The \$800,000 was derived from costs associated with the cancellation of a recent proposed bond sale.

Generally, bond issuance costs such as rating agency fees, advertising, and related expenses are paid out of the proceeds of the bond issuance. In the event that the bond sale is cancelled, however, there are no proceeds from which to make the payments, yet the costs have been incurred and payment is owed by the state. Over the last ten years, the STO has had to cancel four bond sales, and with the increasing uncertainty and volatility in the fixed-income market, the prospects for additional cancellations have increased.

The proposed BBL is:

Item 8860

Notwithstanding any other provision of law, upon certification by the State Treasurer's Office, the Department of Finance may authorize expenditures of up to \$800,000 in excess of the amount appropriated for this item for the payment of rating agencies' fees and advertising expenses on general obligation bond, lease revenue bond, and revenue anticipation note sales that have been cancelled after the cost were incurred. The Department of Finance shall provide notification in writing to the chairpersons of the fiscal committees of each house of the Legislature and the Chairperson of the Joint Legislative Budget Committee no more than 30 days after such authorization.

Staff has no concerns with this request.

Staff Recommendation: Adopt May Revision proposed Budget Bill Language.

ITEM 2240 DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT**Issue 1: Reducing State Government**

The Governor's May Revision proposes Reducing State Government cuts and reductions, four of which have an effect on the Department of Housing and Community Development:

1. **Eliminate Child Care Monitoring Support-** A decrease of \$10,000 General Fund in 2011-12 in the Department of Housing and Community Development (HCD) because these programs have been abolished.

Prior to 2004-05, HCD administered two GF-funded funds that were intended to provide loans and loan guarantees for private child care centers. In 2004-05, the Budget Act transferred the remaining money from those funds back to the GF, but the funds themselves were not abolished. HCD has not made any new awards of the funds since 1998. In 2009, the funds were abolished as part of the general government budget trailer bill.

2. **Eliminate Preservation Technical Assistance-** A decrease of \$35,000 General Fund in 2011-12 for HCD, which would eliminate funding to provide assistance in the prevention of subsidized housing converting to market rents upon the expiration of the subsidy period.
3. **Eliminate Redevelopment Housing Funds Oversight-** A decrease of \$123,000 General Fund 1.4 personnel years in 2011-12 for HCD, which would eliminate funding for oversight of redevelopment agency low-and moderate- income housing funds and an annual report on housing converting to market rents upon the expiration of the subsidy period.
4. **Reduce Housing Policy Funding-** A decrease of \$1.3 million General fund and 8.5 personnel years in 2001-12 in the Division of Housing Policy Development in HCD.

Staff Recommendation: 1. Approve the May Revise proposal to eliminate the Child Care Monitoring Support. 2. Reject the elimination of Preservation Technical Assistance and Redevelopment Housing Funds Oversight. 3. Reject the reduction to Housing Policy Funding.

ITEM: 1760 DEPARTMENT OF GENERAL SERVICES**ISSUE 1: California Health Care Facility**

The Governor's May Revision proposes that provisional language be added authorizing Department of Finance to augment DGS' budget for additional workload costs related to construction inspection services for the California Health Care Facility (CHCF) project in Stockton.

BACKGROUND

AB 900 authorized more than \$7 billion in funding for state prison projects including health care, reentry facilities and local beds to ease the overcrowding in California's prisons and local jails. AB 900 also provides prison rehabilitation resources to improve public safety by reducing recidivism rates. However due to recent budget actions these rehabilitation resources have been removed from CDCR's budget.

On November 8, 2010 CDCR broke ground for a 1.2 million square foot prison medical facility on 400 acres of state-owned land south of Stockton. The CHCF is a medium-level medical and mental Health care facility. Estimated cost for this projection is \$906 million. The fund source in DGS is the Architecture Revolving Fund (0602). The costs will be billed to and reimbursed by CDCR from AB 900 lease and revenue bond.

The Department of General Services, Real Estate Services Division (RESA), Professional Services Branch (PSB), Construction Services Section (CSS) is charged with providing construction inspection services under Government Code 14951 and Health and Safety Code 129900. CSS is responsible for monitoring and inspecting the construction of State Capital Outlay projects to ensure that the projects comply with approved plans, specifications and time schedules. This involves on-site evaluation of the progress of the construction projects and certification of the projects upon completion.

STAFF COMMENT

Staff recommends adopting the May Revision letter with the following amendment to clarify intent of language to prohibit DGS from increasing rates charged to other departments as a result of an adjustment made pursuant to the language proposed and would seek Finance approval to do so. The provisional language shall read as follows: *"Any augmentation made in accordance with this provision shall not result in an increase in any rate charged to other departments for services or the purchase of goods without the prior written consent of the Director of Finance."*

Vote-Only Action: Approve May Revision Proposal with Subcommittee amendments to BBL

CONTROL SECTIONS 3.91 STATE OPERATIONS REDUCTION AND 13.25 REORGANIZATION AND CONSOLIDATIONS

ISSUE 1: Commission Eliminations and Consolidation

The Governor's May Revision includes changes to Control Section Language to facilitate capturing of savings from the proposal to eliminate and consolidate state commissions and other reductions.

BACKGROUND

The March Budget assumed \$250 million in unallocated state operations savings from the adoption of various cost saving mechanisms, like the vehicle fleet reduction and reduction to the number of state issued cell phones. Control Section 3.91 enables savings from such efforts to be captured for purposes of achieving the General Fund savings assumed in the budget.

The May Revision includes proposals that achieve \$41.5 million of savings. Some of these proposals include the consolidation and elimination of state commissions. Control Section 3.91 and 13.25 have been changed to capture this savings and facilitate the changes to the budget associated with the commission elimination and consolidation plan.

STAFF COMMENT

The Assembly Budget Committee has allowed each subcommittee to vet the merits of these proposals separately. This vote only action clarifies that actions taken in the Subcommittees are controlling on the text of the two Control Sections and that they should be edited accordingly.

Preliminary estimates across all subcommittee suggest that at least \$21.5 million of the \$41.5 million in savings will be achieved through policy decisions reached before next fiscal year.

Vote-Only Action: Conform Control Section 3.91 and Control Section 13.25 to actions adopted in the appropriate subcommittee. Also adopt placeholder Supplemental Report Language, pending further language refinements and to incorporate the actions of the other budget subcommittees on the May Revision proposals.

0502 CALIFORNIA TECHNOLOGY AGENCY

ISSUE 1: CTA Savings Reporting

The Senate requested CTA report on savings achieved through its operations and efforts.

BACKGROUND

On May 5, 2011, Senate Budget Subcommittee #4 took the following actions:

- Adopting both budget trailer bill and supplemental report placeholder language to improve upon existing reporting metrics to capture these types of additional elements of the 2009 Governor's Reorganization Plan (GRP) implementation efforts. Developed collaboratively with the LAO, Technology Agency, and DOF, the additional metrics would include: (1) reporting on cost (and risk) avoidance and (2) any potential impairments that have been identified to the continued successful implementation of the GRP; and,
- Adopted additional placeholder supplemental reporting language a process be established to convene an annual meeting on the overall status of the implementation of the GRP, and more specifically on lessons learned to date and what barriers to success have been identified. Finally, staff recommends that a copy of the annual report on IT savings also include cost avoidances and that report be transmitted to the Joint Legislative Budget Committee and fiscal committees of both houses of the Legislature.

STAFF COMMENT

CTA has provides some of the information, upon request, to the Subcommittee in the past, but this request would require CTA to provide this information to the Legislature on a systematic basis.

Vote-Only Action: Conform to Senate

0840 STATE CONTROLLER'S OFFICE**ISSUE 1: Property Tax Postponement**

The Property Tax Postponement program would be re-established in 2012.

BACKGROUND

For more than 30 years, the Senior and Disabled Citizens Property Tax Postponement (PTP) program helped thousands of low-income Californians remain in their homes by postponing their property taxes. Approximately 5,000 persons annually took advantage of the program, until it was eliminated in the February, 2009 budget package.

Under the program, the state paid the property taxes owed to the counties on behalf of eligible participants as a loan. The property was ultimately sold or transferred (usually after the participant was deceased), the state would be repaid with interest.

Since the program was disbanded in 2009, participants previously in the program have been at risk of foreclosure by banks holding title to their mortgages because they have now become delinquent on their property taxes.

Currently, funds continue to be repaid to the state every year for PTP loans issued in the years prior to the program's elimination in 2009. As of April 2011, \$10,000,000 (eight million dollars) has been repaid. The funds reside with the State Controller's Office each year until they are redeposited in the General Fund or elsewhere.

STAFF COMMENT

By keeping the approximately \$10 million in Senior Citizens and Disabled Citizens Property Tax Postponement Program fund received in the budget year from existing loan repayments, a healthy fund balance could be established to allow the program to begin again in 2012-13. This would result in some General Fund costs, as these funds would not be available to offset General Fund expenses.

Vote-Only Action: Maintain up to \$10 million of loan repayments from the Property Tax Postponement program in the Senior Citizens and Disabled Citizen Property Tax Postponement Fund.

CONTROL SECTION XX: TRANSFER OF FUNDS

ISSUE 1: Legislative Transfers

Adopting Budget Control Language will allow the Legislature the ability to move money out of its own budget.

BACKGROUND

Over the last several years the Assembly has made internal budget reductions and used the savings to help EDD hire staff to address Unemployment Insurance workload, to help restore CalWORKs Stage 3 Child Care, and to cover CalFire expenses during relating to wildfires. In some cases, these reductions have resulted in direct General Fund savings to the State.

The actions taken to date have been made by having the Assembly enter into a Memorandum of Understanding with the appropriate state department. However, both houses of the Legislature lack the authority to move funding from their own budget if an MOU is not possible.

STAFF COMMENT

Staff is working with Legislative Counsel to insert language in the appropriate Control Section to allow the each House of Legislature to transfer funds from the budget of the house to other departments.

Vote-Only Action: Adopt Control Section Changes to allow the Legislature, at its own discretion, to transfer funds.

9300 PAYMENTS TO COUNTIES FOR HOMICIDE TRIALS

ISSUE 1: Del Norte County Trial Costs

Del Norte County has experienced two high-cost homicide trails and will request state relief.

BACKGROUND

In order that the cost of homicide trials not unduly impact local government finances, counties may apply to the State Controller for reimbursement of homicide trial and hearing costs that exceed a specified percentage of assessed property value in the county.

STAFF COMMENT

Del Norte County has experienced two high-cost homicide trails and will request \$700,000 of state relief.

Vote-Only Action: Adopt \$700,000 for Homicide Trials relief for Del Norte County

ITEMS TO BE HEARD**ITEM TAXES AND REVENUES**

The May Revision leaves the Governor's January revenue proposals largely intact, but does make some important policy changes to certain aspects of the plan. There are slight changes to the proposal to maintain the temporary tax increases as well as three significant changes with respect to tax policy. The proposal to maintain the temporary tax increases was approved by the Subcommittee in February. With respect to the policy changes, the May Revision leaves in place the January Budget proposal for a mandatory single sales factor for the apportionment of income of multistate corporations as well as market rules for the assignment of sales. These two measures were adopted by the Subcommittee in February. The May Revision includes changes to the January Budget enterprise zone (EZ) program proposal, expands the existing jobs credit, and proposes a new program for exempting a portion of the SUT on the purchase of capital equipment

ISSUE 1: MAINTAIN TAX RATES AND CREDITS

The core of the Governor's proposal consists of maintaining increases in the personal income tax (PIT), sales and use tax (SUT) and vehicle license fee (VLF). Specifically, the Assembly Budget Committee in February approved maintaining for five years the following tax increases:

- PIT surcharge of 0.25 percent.
- Decrease PIT dependent credit exemption.
- VLF rate increase of 0.50 percent
- Increase in SUT rate of 1 percent.

In the January Budget, the PIT increases would benefit the General Fund while the VLF and the SUT changes were earmarked for the realignment proposal. In the May Revision, this demarcation generally holds; however, a minor portion (0.1 percent) of the VLF increase is shifted to benefit the General fund. In one other distinction from the January proposal, the PIT surcharge triggers off in tax year 2011 and triggers on again in 2012.

COMMENTS

The May Revision's proposal with respect to the taxes discussed above (together with certain policy changes outlined below) result in a reduction in taxes from the January Budget of \$2.9 billion. This action reflects the moderate improvement in the state's revenue outlook, particularly with respect to the PIT. However, substantial concerns remain regarding the structure budget challenge facing the state, necessitating the continuation of the temporary tax increases. Staff recommends the Subcommittee adopt the proposed minor changes to this portion of the Governor's revenue package.

Staff Recommendation: Approve May Revision changes to the proposal to maintain the increases in the PIT, SUT and VLF.

ISSUE 2: REFORM ENTERPRISE ZONES

The Governor's January proposal called for eliminating EZ tax credits as well as other tax incentives. Instead of outright elimination of all the EZ tax incentive programs, the May Revision proposes substantial reforms to the hiring tax credit portion of the program. This is the largest of all the EZ tax programs. Under the May Revision, the carryover of tax credits would be limited to 5 years and carryover credits older than 5 years would be eliminated. In addition, the credit would apply to EZ businesses, but would not be limited to vouchered individuals. Instead it would be applicable to all new incremental hires. Finally, the reforms address two perceived weaknesses regarding the existing program design; that is, the program (1) simply encourages hiring rather than actual new job creation, and (2) provides a reward as opposed to an incentive for hiring. Specifically:

- **Job Creation.** Under the current program, a business that lays off 5 employees and hires 1 eligible employee, gets the same amount of credit as a business that hires 1 new eligible employee, even though the first business has eliminated a net of 4 jobs. To ensure actual job creation, the new credit would be available only when hiring resulted in an incremental increase in total employment over a base amount as determined by the prior year's employment level. In addition, the specific criteria for eligible employees would be dropped and the credit would be made available to all hires irrespective of their characteristics..
- **Incentive Aspects.** Under the current program, businesses can claim the credit by amending previously filed returns, often as the result of "retro-vouchering." (Retro-vouchering involves scouring past hires to see if they would qualify for the credit.) These features---retro-vouchering and amended returns—indicate the current program often does not act as an incentive to hire but rather a reward for behavior that would have occurred anyway. The proposed revision would address this by requiring credits to be claimed on an original return and also disallow vouchers prior to 2011 if the claim was made more than 30 days after employment.

COMMENTS

The May Revision's changes to the proposal retain the EZ program as a means to address employment problems in certain designated areas of the state. The reforms do not completely address the more fundamental issue identified in January Budget that EZ programs simply shift jobs around the state rather than creating new jobs. However, the use of base level employment as a means of establishing a threshold is an attempt to at least curtail some of the revenue loss due to awarding a credit for behavior that would have occurred irrespective of the availability of the tax credit.

Staff Recommendation: Replace prior action approving January Budget proposal to eliminate EZ programs, with May Revision reform proposal for the EZ hiring credit.

ISSUE 3: EXPAND JOBS CREDIT AND OUTREACH

The May Revision includes changes to the state's existing jobs tax credit that was established as part of the 2009-10 Budget Act. The Legislature allocated \$400 million for a new jobs credit for small business. The purpose of the credit, which is capped, is to stimulate job creation, especially during the early part of the economic recovery. Given the current rate of utilization, it is likely that the credit cap will not be reached within the five-year economic recovery time frame. The underutilization—relative to expected usage—is likely due to lack of information about the credit and documentation and application requirements.

In order to address the underutilization of the credit, the administration proposes:

- Increasing the amount of the credit from \$3,000 to \$4,000 per new employee; and,
- Expanding the eligible businesses from employers with 20 employees or few to those with 50 or fewer.

In addition, the administration proposes to sunset the tax credit 2012. The proposal includes the funding of \$279,000 General Fund for a public awareness undertaking by the Business, Transportation and Housing agency (BT&H). This funding will provide for one staff and consulting services to ensure small businesses are aware of the tax credit program.

COMMENTS

The proposals by the administration are a reasonable means by which to stimulate the use of the credit when it is most needed—during the economic recovery phase. The outreach is a suitable means by which to ensure that additional drawdown of the credit occurs. Approving the additional positions in BT&H agency would accomplish this. By making the credit more available and increasing the size of the credit, the additional General Fund cost over the January Budget is \$96 million in 2010-11 and \$47 million in 2011-12.

Staff Recommendation: Approve May Revision proposal to reform the jobs credit and funding request for additional authorization of \$279,000 in Item 0520 for outreach regarding the tax credit program.

ISSUE 4: EXEMPT CAPITAL PURCHASES FROM SALES AND USE TAX

The May Revision proposes a new program to exempt from a portion of the sales and use tax (SUT) the purchase of manufacturing equipment. The program as proposed would allow existing businesses a 1 percent exemption from the General Fund SUT on the purchase of manufacturing equipment. Start-up firms would be eligible for an exemption from the 5 percent of the General Fund SUT rate. The exemption would begin in fiscal year 2012-13 and continue for as long as the proposed increase in the SUT rate (discussed in Issue 1 above) remained in place, that is, until 2015-16.

COMMENTS

The Governor's policy proposal attempts to partially address a perceived issue of double-taxation. Under current law, double taxation can occur when equipment or machinery used to manufacture or fabricate a product is taxed and the tax is embedded in the cost of producing an item. If the fabricated product is destined for retail sale and is subsequently taxed, the result is a tax upon a tax, or double-taxation. The proposal would partially address this concern and place California in a more competitive position with many other states, where SUT exemptions of this type are relatively common. Many economists acknowledge the aspect of double-taxation this policy is meant to address, but also observe that the sales tax base is limited to tangible personal property. That is, the value of services that are incorporated in a product are not taxed. If the value of the service is incorporated in the retail sale of another service, such value escapes taxation altogether.

Staff Recommendation: Adopt the May Revision proposal for partial sales and use tax exemption on capital acquisitions.

ITEM 0840 STATE CONTROLLER'S OFFICE

The State Controller is the chief fiscal officer of California. As a separately established constitutional office, the State Controller's Office (SCO) provides fiscal control for, and independent oversight of, more than \$100 billion in receipts and disbursements of public funds. In addition, the Controller offers fiscal guidance to local governments and its audit functions uncover fraud and abuse of taxpayer dollars. The budget proposed for 2011-12 is \$219 million, along with 1,416 positions.

ISSUE 1: LOCAL GOVERNMENT OVERSIGHT INITIATIVES

State financial oversight of local governments is broadly limited to state and federal revenues that are passed-through. There are currently statutes that address various reporting and audit requirements local governments must follow with respect to local funds. Generally, however, current law allows the local governments themselves to ensure compliance. In the recent past, there have been cases where statutes have been violated, resulting in significant occurrences of malfeasance and potential criminal behavior. Arguably the most significant these instances occurred in the City of Bell, where the SCO found \$6 million of unallowable taxes, mismanagement of \$50 million in bond proceeds, illegal contracting, conflicts of interest in financial decision-making, misuse of state and federal funding, as well as other improprieties.

Although local governments are in general responsible for regulating and monitoring their own activities, the state can play an indirect oversight role, including:

- **Annual Audits.** Cities must have an annual report filed by an independent auditor and filed with the SCO. In addition, the SCO is authorized to initiate a quality control review of review of work papers of any audit and refer any findings to the State Board of Accountancy for action;
- **Financial Transaction Reports.** The SCO compiles the financial transactions report based on information provided by local government entities. If the local government reports are deemed by the SCO to false or incomplete, the SCO can initiate an investigation to ascertain the veracity of the information. Repeated investigations can trigger a referral to the Grand Jury; and,
- **Accounting and Audit Guidelines.** Uniform accounting guidelines are currently only applicable to counties, and special districts (including RDAs and JPAs). Audit guidelines are currently only applicable to special districts, including RDAs.

SCO indicates that it currently has insufficient resources to adequately maintain a sufficient monitoring presence with respect to these oversight activities authorized under current law as well as proposed expanded authority. For example, it is not able to compare financial reports over time or between similar entities in order to identify potential problem areas. To the extent such added activities reveal problems, without additional; resources, there would need to be a redirection from other activities. The department argues that unless additional financial oversight is provided, the state will continue to be vulnerable to mismanagement and abuse of local, state and federal pass-through funding. Pressure may be put on the state to assist financially and the state's credit rating could suffer.

Spring Finance Letter. The SCO requested \$2.1 million in reimbursement authority to support 16.4 existing permanent positions beginning in 2011-12 to provide increased oversight of local government entities. Local governments that would be the focus of oversight include cities,

counties, special districts, redevelopment agencies and joint powers authorities. The SCO indicates that the increase in oversight would be based on the SCO current authority and would require no additional statutory language. The Subcommittee heard this issue at its May 3 hearing and requested additional clarifying information be provided by the SCO. In response to the Subcommittee's request, the SCO clarified the nature of the request with respect to current and proposed expanded authority to audit local government entities. In addition, the SCO provided a more detailed audit plan that indicated the proposed deployment of resources among cities, counties, redevelopment agencies, and special districts. The Subcommittee has taken no formal action on the item.

May Revision. The SCO has also requested an additional \$1.4 million in General Fund support and 11.8 permanent positions beginning in 2011-12 to provide increased oversight of local government entities, including counties, counties, special districts, redevelopment authorities and joint powers authorities. The proposal would also statutorily expand the authority of SCO to conduct additional audits based on specified criteria, require annual audits of all local governments (including those with limited expenditures), post recent audits on the SCO audit website, and standardize and increase penalties for noncompliant local government entities. The SCO proposal includes Trailer Bill Language (TBL) that would grant it the additional required authority as well as other statutory changes.

COMMENTS

The undeniable need for additional oversight of local governments has been amply demonstrated. SCO has also shown that its current level of resources is inadequate to provide such additional presence.

- Regarding the Spring Finance Letter, the audit plan does indicate that the workload projection is somewhat speculative, and for this reason, staff suggests reducing funding and position authority by 50 percent and making the position authority 3-year, limited-term. In addition, given the sensitivity and importance of local government financial performance, an annual report on the results of the funding and substantive findings of audit activity should be provided to the Legislature. This is consistent with the LAO's recommendation.
- Regarding the May Revision proposal, the expanded authority encompasses numerous changes to policy, most of which are being addressed by proposals which are currently making their way through the legislative process. The proposed TBL associated with the May Revision consists of expanded audit authority to include financial audits, requiring filings from all local governments irrespective of fund magnitudes; revisions in the penalties applied to late reports or non-reporting. Given the direct policy implications, staff believes these proposals should be deliberated through the legislative rather than budgetary process. In addition, any additional hiring should be delayed until the expansions associated with the Spring Finance Letter are absorbed.

Staff Recommendation:

(1) Spring Finance Letter—Approve reimbursement authority of \$1.049 million and 8.2 positions based on a three-year, limited-term basis and adopt placeholder SRL requiring an annual report to the Legislature on the results of the local government oversight program.

(2) May Revision—Do not approve May Revision budget funding request regarding local government oversight and refer statutory issues to legislative policy process.

ISSUE 2: UNCLAIMED PROPERTY COMPLIANCE INITIATIVE

The SCO operates the unclaimed property program which seeks to unite owners with their lost property. The program seeks to increase the awareness of holders of unclaimed property, to safeguard the property by holding it in fiduciary capacity, and ultimately restore the unclaimed property to the rightful owner. Under current law, the SCO is responsible for safeguarding unclaimed property until it is reunited to the rightful owner.

January Budget. The January Budget included \$293,000 from the Unclaimed Property Fund for 1 permanent and 3.1 two-year limited-term positions in 2011-12. In recent years, there have been legislative and systems changes which increase the workload in the areas of financial accountability, corporate actions, and the collection of securities. The goal of this program is to expedite the return of investment property to owners by increasing the ability of the SCO to 'call in' securities held outside of SCO, thus facilitating their return to owners or sold as required by law. The resources request and approved by this Subcommittee at its February 1 hearing are designed to allow the SCO to maintain stock and mutual fund accounts, ensure compliance with the Unclaimed Property Law, and decrease the timeframe in which owners are reunited with their property.

May Revision. The May Revision includes a request for additional funds from the Unclaimed Property Fund to administer the Unclaimed Property Holder Compliance Initiative. The request is for \$2.4 million and 22.6 positions to address the workload associated with unclaimed property held by businesses. The SCO expects that the initiative will result in returning \$113 million to owners of the property over five years and \$136 million being seceded to the state to be held in perpetuity for the owners to claim. The proposal would result in net receipts to the General Fund in 2011-12 of \$16.8 million, including \$9.7 million in penalties and interest.

The SCO estimates based largely on data provided by the Franchise Tax Board, that there is only a 2 percent compliance rate with existing requirements for businesses to file a report on their unclaimed property with the SCO. The SCO estimates that in excess of 850,000 are required to report, while only 17,000 report on an annual basis. While it is reasonable that not all of the remaining businesses would have a reporting requirement, SCO indicates that the remainder would "likely" have unclaimed property that should be reported. SCO indicates the non-reporting could be due to lack of knowledge of the reporting requirement, the difficulty and expense of reporting, the interest cost imbedded in remitting property, financial advantages from retaining unclaimed property, or the low risk of detection.

The SCO has worked over the years to address non-compliance, but has not had the capacity to make serious in-roads and improve the degree of reporting. The SCO proposal seeks to improve the level of compliance using a multi-pronged approach consisting of outreach, education and auditing. In particular, efforts will include:

- Developing educational and outreach materials;
- Conducting outreach efforts and assistance;
- Researching businesses most likely to non-report;
- Identifying and contacting businesses out of compliance; and,
- Establishing follow-up audit presence.

The SCO expects the program to result in \$113 million in property being returned to owners over a five-year period as well as \$136 million being remitted to the state over the same period (this later property is held in perpetuity for owners to claim). The property returned to owners and remitted to the state would be the result of both the outreach efforts as well as the outcome of audits.

COMMENTS

The program represents a new initiative on the part of the SCO to make in-roads on noncompliance in the unclaimed property area. Because of the lack of internal data, the SCO has relied on FTB data that may be only suggestive of the level of non-reporting as well as the amount of unclaimed property. In view of the newness of the initiative and the uncertain outcomes, staff suggests that funding the positions be on the basis of two-year, limited term and the SCO report to the Legislature on outcomes after the first full year of the program. Assuming a delay in the program due to hiring and training the audit staff, the report to the Legislature would be due in spring of 2013.

Staff Recommendation: Approve \$2.4 million from Unclaimed Property Fund and 22.6 three-year, limited term positions and adopt placeholder SRL requiring a report to the Legislature on program outcomes after the first full year of implementation.

**ITEM 0971 CALIFORNIA ALTERNATIVE ENERGY AND ADVANCED
TRANSPORTATION FINANCING AUTHORITY**

The California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) was established in 1980 to promote prompt and efficient development of energy sources which are renewable or which more efficiently utilize and conserve scarce energy resources. The intent of the legislation establishing the authority was to promote energy sources designed to reduce the degradation of the environment. The authority later was expanded to include development and commercialization of advanced transportation technologies. CAEATFA consists of five members and is chaired by the State Treasurer. CAEATFA's budget and personnel resources proposed for 2011-12 are \$25.8 million and 7 positions, respectively.

ISSUE 1: IMPLEMENTATION OF CALIFORNIA ENERGY COMMISSION PROGRAMS

The Governor's 2011-12 budget for CAEATFA includes reimbursement expenditure authority of \$9 million to implement the California Energy Commission's (CEC's) California Ethanol Producer Incentive Program (CEPIP) under the Alternative and Renewable Fuel and Vehicle Technology Program as authorized by AB 118 adopted in 2007. AB 118 authorizes the CEC to provide incentives of up to \$100 million annually for the development and deployment of clean, efficient, and low-carbon alternative fuels and technologies. AB 118 also provides up to \$50 million per year for the Air Quality Improvement Program administered by the Air Resources Board. The programs funded under AB 118 are supported primarily by various vehicle-related fees. CAEATFA's role in implementing AB 118 is to facilitate and execute disbursement of AB 118 moneys through its financing mechanisms to selected facilities that use alternative energy sources and technologies, and/or that develop and commercialize advanced transportation.

CAEATFA and CEC entered into an interagency agreement that provides for CAEATFA's assistance to CEC in implementing the ethanol incentive program. The terms of the agreement extend for 4 years and allow CEC to transfer to CAEATFA up to \$15 million; to date, \$6 million has been transferred. The proposal is for a transfer of \$15 million in the current year and \$9 million in the budget year, thus exceeding the interagency agreement. CAEATFA indicates that this is due to uncertainty regarding the distribution of expenditures.

The Legislature has expressed a great deal of interest in the AB 118 program administered by CEC, and as such, has statutorily required that the CEC annually submit an AB 118 Investment Plan to the Legislature. This requirement is designed to improve the Legislature's oversight of the AB 118 program. At its January 31 hearing, the Subcommittee acted to deny this request without prejudice, based on the fact that it had not been provided with nor given an opportunity to review, the required Investment Plan.

Since that time, the Investment Plan has been received and it generally paints a grim picture of the likely success of price supports for ethanol production, given increased commodity prices. The report states that CEC will evaluate the future of CEPIP and study the benefits of the intimal \$6 million before making a recommendation on funding.

COMMENTS

Given the nature of the evaluation in the Investment Plan, additional dollars for ethanol subsidies would not appear to be the most cost effective use of AB 118 resources at this time. Given that CEC has indicated that they will evaluate the future of the CEP/IP program, it would seem prudent not to fund the request at this time. The Senate subcommittee denied the funding but approved reimbursement of \$48,000 to administer the \$6 million that has been transferred to date. This seems a reasonable course of action and the recommend action would conform to the Senate.

Staff Recommendation: Approve reimbursement at the level of \$48,000 for 2011-12.

ITEM 1880 STATE PERSONNEL BOARD
8380 DEPARTMENT OF PERSONNEL ADMINISTRATION

The five-member State Personnel Board (SPB), whose members are appointed by the Governor for ten-year terms, was established in the California Constitution in 1934. The SPB is responsible for California's civil service system. SPB mission is to ensure that the state's civil service system is free from political patronage and that employment decisions are based on merit. SPB provides a variety of recruitment, selection, classification, appellate, goal setting, training, and consultation services to state departments and local agencies.

The Department of Personnel Administration (DPA) is the Governor's chief personnel policy advisor. DPA represents the Governor as the "employer" in all matters concerning state employer-employee relations. DPA is responsible for all issues related to salaries, benefits, and position classification. For rank and file employees, these matters are determined through the collective bargaining process and for excluded employees, through a meet and confer process. DPA's main objectives are as follows:

- Represent the Governor in collective bargaining with unions representing rank and file state employees;
- Set salaries and benefits for employees excluded from collective bargaining and employees exempted from civil service;
- Manage salaries, benefits, position classification, training and all other aspects of state employment other than those areas assigned to the State Personnel Board under the civil service provisions of Article VII of the California Constitution;
- Serve as the sole fiduciary and administrative body for the Savings Plus Program (defined contribution program for full-time and part-time state employees);
- Provide legal representation to state agencies in labor relations and appeals of disciplinary actions; and,
- Hold ex-officio membership to the 13-member Board of Administration of the California Public Employees' Retirement System.

ISSUE 1: CONSOLIDATION OF STATE PERSONNEL BOARD AND DEPARTMENT OF PERSONNEL ADMINISTRATION

The May Revision includes a proposal to consolidate the SPB and DPA in a single Department of Human Resources. The proposal indicates that this structure would more efficiently manage and administer the state's human resources functions. The consolidation would be effective July 1, 2012 and is estimated to result in savings in 2012-13 of \$2.2 million from all funds and \$300,000 General Fund and 24.2 personnel years. For 2013-14 and on-going, the estimated savings from the consolidation would be \$4.3 million in all funds, \$700,000 General Fund and 48.3 personnel years.

Also included in the May Revision is a proposal to eliminate the Human Resources Modernization Project. The elimination would result in total savings in 2011-12 of \$5.5 million (\$2.3 million General Fund) and 11.3 personnel years. This project was initiated in 2007-08 in an effort to streamline the state's civil service program. It would be absorbed with the proposed Department of Human Resources.

COMMENTS

In general, the proposal would appear to have some merit. The primary mission of each of the entities is related to state employees and employment, although with a difference in focus. Given the share subject matter, there is certainly an opportunity for more sharing of information and expertise and coordination of activities that a unified department might facilitate. Nevertheless, the May Revision proposal provides no details on how the consolidation would be carried out or the organizational structure that would be put into place in order to fulfill the missions of each of the current departments. There are numerous decisions on such a consolidation that would raise significant policy choices and decisions on the most appropriate deployment of resources. For these reasons, staff recommends that the Subcommittee take no action on this proposal but refer it to the legislative process for a full development and vetting of the proposal. The Little Hoover Commission is slated to hear this issue June 2, 2011.

Given the pending proposal to combine State Personnel Board and the Department of Personnel Administration into a single entity, it makes sense to combine employment and human resources related modernization efforts as well. DOF indicates that the modernization work will still be carried-out and can be absorbed by the department with established resources. For this reason, staff recommends that the proposal to eliminate the current modernization project be approved, the ongoing efforts absorbed by the department, and the proper approach to this effort be a part of the consolidation discussion. Staff recommends adopting the elimination of this modernization initiative and realize the savings to the General Fund and other funds.

Staff Recommendation: Do not adopt May Revision request regarding the consolidation of the State Personnel Board and the Department of Personnel Administration and refer issue to legislative policy process. Adopt the May Revision proposal to eliminate funding for the Human Resources Modernization Project.

ITEM 8885 COMMISSION ON STATE MANDATES

The Commission on State Mandates (COSM) is charged with the duties of examining claims and determining if local agencies and school districts are entitled to reimbursement for increased costs for carrying out activities mandated by the state. COSM was created as a quasi-judicial body and made up of the Director of Finance, the State Controller, the State Treasurer, the Director of the Office of Planning and Research, a public member with experience in public finance, and two additional members of local public bodies appointed by the Governor and approved by the Senate. This budget item appropriates the funding for staff and operations costs of COSM and appropriates non-education mandate payments to local governments.

The Legislature adopted major solutions in the funding of mandates that are now in pending legislation. The major solutions were:

- Suspension of State Mandates—Decrease of \$228.3 million in 2011-12 as a result of suspending most mandates not related to law enforcement or property taxes.
- Deferral of Pre-2004 Mandate Obligations—Decrease of \$94 million in 2011-12 as a result of deferring the 2011-12 payment for costs incurred prior to 2004-05.

ISSUE 1: LOCAL ASSISTANCE

- (1) Law Enforcement Mandates.** The May Revision proposal calls for additional changes to the funding of mandates as a result of changes to the realignment proposal. Under the Governor's proposal, the law enforcement mandates, instead of being funded through the realignment, will be funded through the General Fund. These mandates include those related to peace officer protections, domestic violence arrest policies, victim assistance and treatment services, child abduction and recovery services, and civil commitment procedures for sexually violent predators.

Staff has no Issues with this proposal.

- (2) Fiscal Impact Adjustments.** The proposal also calls for funding adjustments based on reports from the State Controller's Office regarding the cost of funding the law enforcement and property tax mandates for a decrease of \$3.9 million.

Staff has no issues with this proposal.

- (3) Deferral and Suspension.** Funding is also adjusted to account for statewide cost estimates for Local Government Employment Relations (LEGR) and Local Agency Formation Commissions (LAFCO). The first of these is proposed for deferral and the latter for suspension, resulting in no net change in funding. The Legislative Analyst's Office (LAO) recommends the LAFCO mandate be addressed through a modification to the existing reporting requirement and has proposed Trailer Bill Language. LAO also recommends that the LEGR issue be referred to policy committee since there are no incentives for local governments to control costs.

Staff recommends adopting deferral and suspension of these mandates and referral of LAFCO and LEGR policy-related issues to policy committee.

The proposal calls for Budget Bill Language that will address the various shifts in funding, deferrals and suspensions and decrease the item by \$3.9 million

Staff Recommendation: Approve the May Revision request and proposed Budget Bill Language.

ITEM CS 3.60 AND 6610 CONTRIBUTIONS TO PUBLIC EMPLOYEES' RETIREMENT BENEFITS

The control section provides the mechanism for increases and decreases regarding the state contribution to public employee retirement accounts, based on the determination of required funding levels. The section is the budget bill's mechanism for holding departments' budget harmless in the event of increases in employer CalPERS contribution rates and achieving budgetary benefit for the state when CalPERS rates decline.

ISSUE 1: CALIFORNIA STATE UNIVERSITY RETIREMENT CONTRIBUTIONS

The May Revision calls for Control Section 3.60 to be decreased by \$69.2 million to account for Department of Finance's (DOF's) calculation that California State University's (CSU's) retirement contributions to CalPERS in fiscal year 2009-10 were less than budgeted during that fiscal year. Provisional language would also be required to allow a reduction of this amount from the 2011-12 budget. The proposed provisional language from DOF would also provide an ongoing mechanism through which adjustments could be made to the CSU retirement contributions in a budget year based on actual data from two years prior. As the base for calculating the difference in the budgeted and actual amounts, DOF used fiscal year 2008-09.

CSU indicates that the selection of years for this calculation is significant and drives the result of a \$69.2 million overage. According to their alternative view, other years that would serve as a basis to compare budgeted with actual contributions would result in dramatically different results. CSU's perspective on the proposal is that the funding adjustment is equivalent to a reduction in support that is inseparable from the ongoing reductions that CSU has experienced in recent years. This is because state General Fund support for CSU is not compartmentalized by activity or fund. For purposes of state support, General Fund resources are given to the CSU in aggregate, with budgeting discretion delegated to the system and its constituent campuses. CSU indicates that reduction in one year of \$69 million is on top of the roughly \$500 million that it is slated to absorb in 2011-12.

According to the Legislative Analyst's Office (LAO), neither of the approaches adopted by either CSU or DOF are particularly defensible because they select an arbitrary year as the base year. The circumstances from that year forward are the determinants of the outcome. Since the retirement funds are not segregated and necessary contributions are estimated. If there was an overestimate of the allocation, then such funds would be spent on other departmental programs. Thus, any reduction pursuant to CS 3.60 would be no different than an overall budget cut.

COMMENTS

The process by which DOF arrived at the difference between budgeted and actual amounts is based on a particular year going forward. This "reach-back" is not a procedure which is being applied to other state agencies. In terms of the impact on CSU's budget, it has an impact no different than an unallocated cut to the system. If an overall budget reduction is proposed for the system, this should be addressed directly through the departmental budget, not through a technical process. Staff discussions with CSU, DOF and LAO also revealed an agreement among parties that a process is needed to clarify the use of the CS 3.60 as well as developing a more suitable process for adjustments to retirement contributions.

The proposed budget bill language for 2011-12 is:

Item 8860

It is the intent of the Legislature that the Department of Finance develop and implement a revised process, in consultation with the California State University, that allows the Director of Finance to more accurately adjust the university's appropriation amounts for employer pension contributions beginning in the 2011-12 fiscal year, as allowed in subdivision (a). The Director of Finance shall submit a brief description of the revised process to the Chairperson of the Joint Legislative Budget Committee and the Chancellor of the California State University on or before January 10, 2012.

Staff recommends rejecting the adjustment to the control section and not approving the administration's provisional language. Instead, under item 8860 staff recommends that DOF be directed to establishing an appropriate and reasonable method for addressing true adjustments for state contributions to the retirement fund

Staff Recommendation: Do not approve May Revision reduction of \$69.2 million in CS 3.60 funds to account for CSU contributions to CalPERS. Adopt placeholder BBL for Department of Finance to develop a new process for adjustments to employer pension contributions.

ITEM 9800 AUGMENTATION FOR EMPLOYEE COMPENSATION

This budget item allows for adjustments in departmental budgets to account for changes in employee compensation, including salaries, health and retirement benefits, based on determination regarding the required funding levels.

ISSUE 1: BARGAINING AGREEMENTS

The May Revision calls for an increase in in employee compensation resulting from the administration reaching agreement on six collective bargaining agreements pending ratification by the Legislature. The agreements would result in increased costs for California Association of Highway Patrolmen consisting of \$96.4 million General Fund and \$23.1 million in other funds. The request is related to CS 3.90, Issue 1.

In addition, the request includes a proposal to allow the Department of Finance (DOF) to adjust the percentage level of the employer contribution rates and health care rates to be consistent with any actions taken by the CalPERS Board after the adoption of the 2011-12 budget. This would apply to separate employer contribution rates for California State University as well as new employer contribution rates for the remaining state member categories. The technical change would also affect control sections 3.60 and 3.90.

Staff has no issues with this proposal.

Staff Recommendation: Approve the May Revision request and Budget Bill Language to allow Department of Finance to make necessary adjustments to account for CalPERS Board actions. Adopt conforming language for Control Sections 3.60 and 3.90.

ITEM CS 3.90 REDUCTION FOR EMPLOYEE COMPENSATION

This control section allows for adjustments in departmental budgets to account for changes in employee compensation, including salaries, health and retirement benefits, based on determination regarding the required funding levels.

ISSUE 1: BARGAINING AGREEMENTS

The May Revision calls for a decrease in in CS 3.90 resulting from the administration reaching agreement on six collective bargaining agreements pending ratification by the Legislature. The agreements would result in a decrease in reduction for employee compensation and an increase funding from the General Fund of \$101.3 million and \$98.2 million from special funds and other funds. The request is related to Item 9800, Issue 1.

Staff has no issues with this proposal.

Staff Recommendation: Adopt May Revision request.

7100 EMPLOYMENT DEVELOPMENT DEPARTMENT**ISSUE 1: SINGLE CLIENT DATABASE MODERNIZATION**

The issue for the Subcommittee to consider is the Governor's May Revision request for augmentation of \$10.7 million (\$7.1 million from the Unemployment Fund and redirection of \$3.6 million from the Disability Insurance Fund) for the Single Client Database (SCDB) Modernization project.

PANELISTS

- Department of Finance
- Legislative Analyst's Office
- Employment Development Department

BACKGROUND

The SCDB project is a multi-year project. EDD one time resources have been allocated to the project and are estimated for future fiscal years as follows on the basis of the Special Project Report currently under review by the California Technology Agency (CaTA):

SFY 2008-09	0.6 PYs	\$4,637,144	Actual
SFY 2009-10	22.6 PYs	\$7,247,968	Actual
SFY 2010-11	30.4 PYs	\$17,652,708	Estimated
SFY 2011-12	20.1 PYs	\$10,721,963	Estimated
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4 Year Total	73.7 PYs	\$40,259,783	Estimated

Nature of Request: The Department of Finance requests a budget augmentation of \$7.1 million in budget authority from the Unemployment Fund and the redirection of \$3.6 million from the Disability Insurance Fund, for 22 existing positions (20.1 Personnel Years [PYs]) for 2011-12.

This request will fund the final year of the SCDB Modernization project that is essential to maintaining the Employment Development Department claim processing services and for the development of EDD automation efforts for the Unemployment Insurance (UI) and Disability Insurance (DI) programs.

On March 11, 2011, CaTA approved the continuation of the SCDB project as presented in January 5, 2011 Special Project Report (SPR) subject to specific conditions. According to the California Technology Agency (CaTA), the SCDB project is on schedule.

Staff Recommendation: Approve the May Revise BCP proposal.

ISSUE 2: ALTERNATE BASE PERIOD

The issue for the Subcommittee to consider is the Governor's May Revision request for augmentation of \$9.1 million (\$8.5 million from the Unemployment Fund and redirection of \$0.6 million from the Unemployment Administration Fund) for the Alternate Base Period (ABP) project.

This Finance Letter also proposes Trailer Bill Language, which would extend the ABP project implementation date to April 2, 2012 from November 3, 2011.

BACKGROUND

Background on Alternative Base Period (ABP). The federal ARRA Unemployment Compensation (UC) modernization incentive payments, of which California's share would be \$838.7 million, requires the state to demonstrate that its UC law contains certain benefit eligibility provisions. To receive one-third of the funding under the federal legislation, a state must have an ABP. In order to receive the remaining funds, a state must provide two of the four benefit eligibility provisions, as defined in ARRA, enacted in state law. States have until September 2012 to fully implement an ABP system. California meets these provisions and the required associated regulation changes have been approved by U.S. Department of Labor (DOL).

In 2009, the Legislature authorized EDD to establish an ABP no later than April 3, 2011. However, the department informed the Legislature of challenges that prevented them from meeting that time frame, due to its dependency on the Single Client Database Modernization (SCDB) project to process claims, and implementation was rescheduled to September 3, 2011 through the 2010 Budget Act.

Nature of Request: The ABP is a multi-year project. EDD one time resources have been allocated to the project and are estimated for future fiscal years as follows on the basis of the Special Project Report that was submitted and approved by the California Technology Agency (CaTA) in March of this year:

SFY 2008-09	0.1 PYs	\$760,772	Actual
SFY 2009-10	4.5 PYs	\$892,816	Actual
SFY 2010-2011	15.7 PYs	\$6,146,245	One-Time
SFY 2011-2012	24.8 PYs	\$9,109,442	One Time/Continuing
SFY 2012-2013	18.2 PYs	\$2,516,457	Continuing
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5 Year Totals	63.3 PYs	\$19,425,732	

The Department of Finance requests a budget augmentation of \$8.5 million in budget authority from the Unemployment Fund and the redirection of \$0.6 million from the Unemployment Administration Fund for 26 existing positions (24.9 Personnel Years) for 2011-12.

This request will fund the final year of development for the ABP project that will allow 26,000 unemployed individuals per year to qualify for approximately \$69 million in Unemployment Insurance (UI) benefits up to three months earlier than would be possible under the current existing base period.

Delays in Implementation: The ABP project is dependent upon the SCDB Modernization project for the collection and storage of data needed to process an ABP claim. The SCDB implementation has been rescheduled to November 2011 as a result of scope changes, programming delays, and

staff reassignments to competing projects. Hence, the ABP implementation has been rescheduled to April 2012 to reflect the change in the SCDB schedule as well as similar issues of scope complexity and resource issues related to competing priorities.

COMMENTS

On March 11, 2011, CaTA approved the continuation of the ABP project as presented in January 21, 2011 Special Project Report (SPR) subject to specific conditions. According to the California Technology Agency (CaTA), the EDD has been meeting the conditions and are on schedule for this project.

On May 17, 2011, EDD submitted an application to the U.S. Department of Labor (DOL) for both the one-third and two-thirds Unemployment Compensation Modernization incentive funds. The DOL is expected to respond within a 30 day timeframe as to the state's eligibility for the full \$839 million in incentive funds.

Staff Recommendation: Approve the May Revise BCP proposal.

ISSUE 3: ALTERNATE BASE PERIOD (IMPLEMENTATION)

The issue for the Subcommittee to consider is the Governor's May Revision request for a redirection of \$5.3 million in Unemployment Administration Fund resources for 2011-12 implementation and ongoing activities related to the ABP project.

Source of Fund	2010-11	2011-12	2012-13
Unemployment Administration Fund		\$5,327,000 (support 35 existing PYs)	
Unemployment Fund	\$48,000,000		\$16,043,000 (support 157 new PYs)

This Finance Letter also proposes Trailer Bill language, which would amend the 2010 Budget Act in order to appropriate \$48 million from the ARRA incentive funds. These funds will be set-aside in a separate account to support ABP program costs through 2014-15.

The remaining \$791 million in incentive funds would be applied to the state's federal loan, resulting in ongoing annual debt service savings of around \$30 million beginning in 2012-13.

BACKGROUND

In May 2011, EDD made significant progress on the ABP development to certify to the U.S. Department of Labor (DOL) that it would fully implement an ABP in September 2012. When DOL approves this certification, California becomes eligible to receive \$839 million in federal incentive funds. These funds may be used to repay the state's federal loan or fund certain administrative costs within EDD. However, due to technical issues related to the UI loan, if the Legislature wishes to appropriate funds for EDD administrative costs it must do so prior to June 30, 2011. Otherwise all of the incentive funds would be applied to the state's outstanding loan balance.

The Administration proposes to appropriate and set aside \$48 million of these federal incentive funds to fund the ABP administrative costs from 2012-13 through 2014-15. Absent this set aside, the ABP costs would likely have been borne by the General Fund, which is estimated at \$16 million a year. The remaining \$791 million in incentive funds would be applied to the state's federal loan, resulting in ongoing annual debt service savings of around \$30 million in 2012-13. The Administration indicates that the \$48 million must be appropriated no later than June 30, 2011, and should there be a delay, it creates uncertainty of reserving these funds to support ABP.

LAO ALTERNATIVE PROPOSAL

The Legislative Analyst's Office developed an alternative approach to generate General Fund savings in the budget year. Their recommendation increases the set aside by an additional \$120 million for EDD administrative costs in 2011-12 through 2014-15, as an opportunity to generate General Fund savings. Specifically, this would result in \$30 million in savings in 2011-12 and ongoing annual savings estimated at \$23 million through 2014-15. However, it is noted that years beyond 2014-15, there is a slight higher debt service costs of approximately \$6 million per year until the state repays its outstanding federal loan.

COMMENTS

The Legislature has to weigh the benefits of near term General Fund savings against future increased debt service costs and a small decrease in the reduction to the UI loan balance.

Staff Recommendation: Approve the May Revise proposal and related trailer bill language.

ISSUE 4: WIA 15 PERCENT EXPENDITURE PLAN

As prescribed by federal law, local workforce investment areas receive about 85 percent of the state's WIA allocation, while the remaining 15 percent of WIA funds are available for state discretionary purposes such as administration, statewide initiatives, current employment service programs, or competitive grants. Every year, the Legislature reviews the Governor's WIA expenditure plan to ensure its consistency with legislative priorities.

BACKGROUND

Due to the delay in the federal government's budget passage, the Administration postponed submission of the WIA 15 percent expenditure plan until the May Revise process. The proposal indicates that for fiscal year 2011-12, no changes have been made to the local assistance of state operations funding for WIA. Although no changes are proposed for state operations funding within each program category, some changes in the array of funded programs are proposed. (Attachment A)

However, there is much uncertainty due to interpretations of the recently enacted federal budget that result in significant reductions to these state discretionary funds, from \$69.1 million to potentially \$20-40 million. Both Department of Finance (DOF) and Employment Development Department are seeking clarification from the U.S. Department of Labor (DOL) before permanent funding adjustments are made.

In addition, the May Revision proposal indicates that the state could have a larger than normal carryover from fiscal year 2010-11. The first expenditure priority is to fully utilize ARRA funding within the WIA Programs by June 30, 2011; therefore, where allowable, the EDD will use these funds before expenditure of the 2010-11 base grant for administrative costs resulting in an increase in carryover funding. Since the final amount of carryover will not be known until July 2011, DOF requests that any adjustments needed in the budget year be made as part of the October Revise.

COMMENTS

Given the uncertainty of the funding levels for the WIA 15 percent expenditure plan, it is recommended that the Legislature provide the Department of Finance and Employment Development Department time to clarify with the federal government, and submit a revised WIA 15 percent plan, based on available federal funds, by September 1, 2011 for review and approval.

Item 7100-001-0869, Employment Development Department

Strike existing Provision 4.

Insert new Provision 5 as follows:

5. Notwithstanding Provisions 1 through 3 of this item in fiscal year 2011-12 only, funds appropriated in Schedules (2) to (4), inclusive, are not authorized for expenditure until the Employment -Development Department and the Department of Finance submit a detailed plan for expenditure based on the available federal funding. It is the intent of the Legislature that this plan be submitted by September 1, 2011. The expenditure of funds may be authorized not sooner than 30 days after this detailed expenditure plan is provided to the chairpersons of the committees in each house of the Legislature that consider the State Budget, and the Chairperson of the Joint

Legislative Budget Committee, or not sooner than whatever lesser time the chairperson of the joint committee, or his or her designee, may in each instance determine.

Staff Recommendation: Approve the revised provisional language that requests DOF and EDD to submit a revised WIA 15% expenditure plan to the Legislature by September 1, 2011.

**ISSUE 5: UNEMPLOYMENT INSURANCE – FEDERAL INTEREST PAYMENT
TECHNICAL ADJUSTMENT**

In a May Revision Finance letter, the Governor is requesting an adjustment to the January budget amount of the Unemployment Insurance (UI) interest payment due to the federal government in September 2011, reducing the total estimated payment by \$42.79 million (Disability Insurance Fund – DI Fund), to a total of \$319.5 million (DI Fund).

BACKGROUND

At the February 3rd hearing, the Subcommittee approved an increase of \$362.3 million General Fund to make the first interest payment due to the federal government for the quarterly loans the Employment Development Department (EDD) has been obtaining from the federal government since January 2009 to cover the Unemployment Insurance (UI) fund deficit. This expenditure was offset by a transfer from the DI Fund to the GF, resulting in no net GF cost in 2011-12.

Background on California's UI Fund. California's UI fund was depleted on January 26, 2009, and at that time the EDD began borrowing funds from the Federal Unemployment Account in order to continue paying UI benefits to qualifying unemployment claimants. The federal loans have permitted California to make payments to UI claimants without interruption. Generally, loans lasting more than one year require interest payments; the federal American Recovery and Reinvestment Act (ARRA) of 2009 provided temporary relief to states from making interest payments on UI loans through December 31, 2010. With the expiration of the ARRA provisions, the first interest payment to the federal government is due in September 2011 with growing interest obligations in the out years. Federal law requires that the interest payment come from state funds; i.e., the payment cannot be paid by the Unemployment Fund or by a state's UI administrative grant.

The May Revision request adjusts downward the September 2011 interest payment due to two factors: (1) updated federal guidance currently estimates an interest rate of 4.087 percent; the January budget level was based on an estimate of 4.36 percent; and (2) a reduction in the amount of federal funds the state will have borrowed at the time the interest payment is calculated; the January budget level estimated a total of \$10.3 billion, the updated estimate is a total of \$9.8 billion.

COMMENTS

This request is simply a technical adjustment to the budgeted 2011-12 federal interest payment. The net effect is that \$41.2 million less will be owed from the DI fund to the GF. The May Revision request makes no changes to the existing budget provisional language that: (1) authorizes the DOF to increase/decrease the actual amount paid/borrowed from the DI fund based on a more precise calculation of the payment due; and (2) specifies that the annual contribution rates for the DI fund shall not increase as the result of any loan made to the GF (in calculating the annual disability insurance tax rate each year, the EDD is required to treat outstanding DI loans as available cash in the DI Fund). This latter provision is key to preventing any potential increase in employee paid DI taxes as a result of the loan from the DI Fund to the GF.

Finally, staff notes that the out year GF implications of not addressing the larger insolvency of the UI Fund are significant. The estimated September 12, 2012, interest liability is \$592.8 million. This figure does not include the roughly \$80 million that the GF will be required to pay out to the DI fund over the next four fiscal years as payment for the 2011-12 loan. Neither the Governor's January

budget nor May Revision proposal, included a proposal to address the underlying insolvency of the UI fund.

Staff Recommendation: Approve the technical adjustment to the Unemployment Insurance federal interest payment in the 2011-12 budget.

5160 DEPARTMENT OF REHABILITATION
7100 EMPLOYMENT DEVELOPMENT DEPARTMENT**ISSUE 1: TRANSFER OF THE COMMITTEE ON EMPLOYMENT OF PERSONS WITH DISABILITY TO THE DEPARTMENT OF REHABILITATION**

The issue for the Subcommittee to consider is the Governor's May Revision proposal to transfer the Committee on Employment of Persons with Disability to the Department of Rehabilitation, generating \$403,000 in other fund savings, and 3.3 personnel years, assuming reduction of 7 of 11 positions.

BACKGROUND

The Commission on Employment of Persons with Disability currently receives staff support from the Employment Development Department (EDD). The Administration's proposal would be to transfer the Commission to the Department of Rehabilitation (DOR), as the promotion of employment of people with disabilities is a core function of the department. Funds from EDD would be redirected to support the work of the commission, increasing the reimbursement provided to DOR by \$234,000 in 2011-12.

The Governor's Committee. The California Governor's Committee on Employment of People with Disabilities (Governor's Committee), as mandated in the California's Workforce Inclusion Act, Assembly Bill 925, shall consult with and advise the Labor and Workforce Development Agency and the California Health and Human Services Agency on all issues related to full inclusion in the workforce of persons with disabilities, including the development of a comprehensive strategy (DOC). The Governor's Committee provided a forum through which state departments, boards, councils, local service providers, business leaders and the disability community collaborated to develop a comprehensive strategy. Achievement of the goals and actions identified in the comprehensive strategy will result in an increased rate of employment for people with disabilities.

The Governor's Committee consists of appointed and mandated public and private members and receives staff support from the Employment Development Department (in the Labor and Workforce Development Agency). It is mandated to meet quarterly, in conjunction with the California Health Incentives Improvement Project (CHIIP). The work of the Governor's Committee is conducted through its three subcommittees listed below:

- Communications and Outreach Subcommittee
- Education and Employment Subcommittee
- Policy and Planning Subcommittee

Staff Recommendation: Approve the transfer of the Governor's Commission on Employment of People with Disabilities to the Department of Rehabilitations; adopt the proposed trailer bill language as modified to retain the Senate Rules Committee and Speaker of the Assembly appointment authority.

0559 SECRETARY OF LABOR AND WORKFORCE DEVELOPMENT**ISSUE 1: ELIMINATION OF THE ECONOMIC STRATEGY PANEL**

The issue for the Subcommittee to consider is the Governor's May Revision request to restructure responsibilities and consolidate labor committees within the labor and workforce agencies.

This proposal would eliminate the Economic Strategy Panel and generate \$79,000 in savings of other funds, and 0.7 personnel years, which requires changes to be made through trailer bill language for enactment.

BACKGROUND

The California Economic Strategy Panel was originally established in statute in October 1993 under the California Technology, Trade and Commerce Agency (Government Code section 15361.10). Ten years later, AB1532 moved the responsibility for the Panel to the California Labor and Workforce Development Agency (see Government Code section 15570).

The Secretary of the Labor and Workforce Development Agency (LWDA) serves as the chair of the California Economic Strategy Panel. The bipartisan Panel, established in 1993, develops a statewide vision and strategy to guide public policy decisions regarding economic growth and development.

COMMENTS

The Agency indicates that the duties and responsibilities can be absorbed within its current structure.

Staff Recommendation: Approve the elimination of the Economic Strategy Panel and related trailer bill language.

ISSUE 2: REDUCE LABOR AND WORKFORCE DEVELOPMENT AGENCY BUDGET

The issue for the Subcommittee to consider is the Governor's May Revision proposal to reduce the Labor and Workforce Development Agency by \$677,000 in reimbursement authority and 3.8 personnel years to reflect reduction of 4 positions within the agency, including 1 position from the Economic Strategy Panel.

The proposal also requests to relocate of the Agency from leased space to the Employment Development Department, which saves \$210,000 in other funds within the Department of Industrial Relations (DIR).

BACKGROUND

The California Labor & Workforce Development Agency is an executive branch agency, and the Secretary is a member of the Governor's Cabinet. The Agency oversees seven major departments, boards and panels that serve California businesses and workers. The budget for all Agency operations totals about \$11.2 billion, and includes approximately 11,600 staff working throughout California.

The Agency was created in 2002, and is the first cabinet-level agency to coordinate workforce programs.

1. Agricultural Labor Relations Board
2. California Business Investment Services
3. California Economic Strategy Panel
4. California Employment Development Department
5. California Unemployment Insurance Appeals Board
6. California Workforce Investment Board
7. Department of Industrial Relations

COMMENTS

The Agency indicates that the duties and responsibilities can be absorbed within its current structure, and because of the reduction in positions, enables to be accommodated into the available space in the EDD building. There a no additional costs incurred to cancel the lease agreement as the renewal date is on August 31, 2011 with a 60-day notice without penalty.

Staff Recommendation: Approve the May Revise proposal.

7350 DEPARTMENT OF INDUSTRIAL RELATIONS**ISSUE 1: ELIMINATION OF THE OSH STANDARDS BOARD**

The issue for the Subcommittee to consider is the Governor's May Revision proposal to eliminate the Occupational Safety and Health Standards Board, generating savings of \$324,000 in other funds, and 1.9 personnel year.

BACKGROUND

The Occupational Safety & Health Standards Board, a seven-member body appointed by the Governor, is the standards-setting agency within the Cal/OSHA program. The Standards Board's objective is to adopt reasonable and enforceable standards at least as effective as federal standards. The Standards Board also has the responsibility to grant or deny applications for variances from adopted standards and respond to petitions for new or revised standards. The part-time, independent board holds monthly meetings throughout California.

COMMENTS

The LWDA indicates that the duties and responsibilities can be absorbed within its current structure.

In order to eliminate the OSH Standards Board, it will require the support of 2/3rd vote in each house of the Legislature. This requirement was made as part of the Proposition 97 from 1988, approved by voters to fully restore the Cal/OSHA Program to the pre-1987 level.

Staff Recommendation: Approve the elimination of the OSH Standards Board and related trailer bill language.

ITEM 1760: DEPARTMENT OF GENERAL SERVICES

ISSUE 1: Surplus Property

The Governor's May Revision includes a proposal to dispose of surplus property that includes property donated to the State for the purposes of creating a state park.

BACKGROUND

The May Revision includes a reference to a DGS effort to sell properties "that serve no state programmatic need." Among the properties listed in the May Revision as "intended for sale include the Los Angeles Coliseum, properties owned and managed by the Capitol Area Development Authority in Sacramento, and the Ramirez Canyon property in Southern California."

Ramirez Canyon Park is located in a canyon off the Malibu coastline and is bordered by a National Park Service wilderness area. Barbara Streisand donated this 22.5-acre estate to the Santa Monica Mountains Conservancy in December 1993. Per the terms of the donation agreement, the land was to be used for the purposes of eventually becoming a park.

STAFF COMMENT

Selling the property could make it possible for the land to be developed. Such a disposition would create a chilling effect of future donations of land to the State for the purposes of parks and open space.

Staff Recommendation: Approve Placeholder Trailer Bill Language Excluding Property Donated to the State for the Purpose of Parks from Being Sold As Surplus Land.
