

AGENDA**Part 1 of 2****ASSEMBLY BUDGET SUBCOMMITTEE NO. 4
ON STATE ADMINISTRATION****Assemblymember Juan Arambula, Chair****TUESDAY, MAY 1, 2007, 1:30 PM
STATE CAPITOL, ROOM 447****CONSENT CALENDAR**

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ITEMS ON CONSENT

CONTROL SECTION 12.00 STATE APPROPRIATIONS LIMIT

This annual Budget Control Section establishes the amount of the State Appropriations Limit for the fiscal year of the budget. Because the final calculation of the limit for 2007-08 must be consistent with the final budget adopted in conference, action must be taken to place this section in conference.

Action: Reduce the amount by \$1 million to place the section in conference (the Senate will approve as budgeted).

CONTROL SECTION 35.50 GENERAL FUND REVENUE ESTIMATE

This annual Budget Control Section establishes the General Fund revenue estimate on which the budget is based for the purposes of the balanced-budget requirement of Proposition 58. Because the final revenue estimate for 2007-08 must be consistent with the final budget adopted in Conference, action must be taken to place this section in conference.

Action: Reduce the amount by \$1 million to place the section in conference (the Senate will approve as budgeted).

ITEMS TO BE HEARD

0855 GAMBLING CONTROL COMMISSION

The California Gambling Control Commission (Commission), under the Gambling Control Act has jurisdiction over the operation, concentration, and supervision of gambling establishments, and over all persons or things having to do with the operations of gambling establishments in the State of California. There are approximately 100 card rooms and 55 tribal casinos currently operating in the State.

The Governor's budget proposes \$136.9 million and 62.7 positions. This reflects a decrease of \$5.6 million from the revised 2006-07 budget.

ISSUE 1: AUDIT WORKLOAD INFORMATION

The 2006 Budget Act included Supplemental Report Language requiring that no later than April 1, 2007, the Commission should submit to the Legislature updated workload information regarding its audit plan. The information shall include an update of the audit plan including:

- The status of backlogged audits and how that affects the implementation of a three-year audit cycle,
- The updated number of hours to complete an audit
- The outcomes of audits completed
- The number of audit positions that have been filled
- The number of vacancies, and an updated calculation of audit staff needs based on the most recent workload information

COMMENTS

The Commission should provide testimony regarding the content and status of the report.

Net Win Audits : What is the number, status and schedule of financial audits of the Tribes' quarterly Net Win calculations (Quarterly Contribution Reports) to the 1) Special Distribution Fund (SDF), and 2) the General Fund. Specifically, what is the number of under reports/over reports and results of any actions taken and number of in-office reviews of quarterly SDF contributions?

Testing of Gaming Devices: 2004 compacts required Tribal Gaming Agencies to submit an annual audit performed by an independent CPA to the Commission in support of the Tribe's compliance with Section 7.5 of the compacts that established Gaming Device Testing requirements. Question to the Commission: What process has been established to review the annual tribal audits to assure compliance with this section of the Compacts, and how many reviews have been performed?

Also, the Commission is authorized to inspect Tribal Gaming facilities on a random basis not to exceed (4) times annually to confirm the slot machines operate and play in conformance with the manufacturer's technical standards. Question: What is the status of the Commission's field inspection program that will be used to test gaming devices? Has a technical services program been developed to develop the technical expertise necessary to determine whether gaming devices are functioning appropriately and to ensure the public that gaming is conducted honestly and fairly?

CONTROL SECTIONS 4.04/4.05 UNALLOCATED REDUCTIONS

Control Section 4.04: Unallocated “Price” Reduction

In a letter dated January 19, 2007, the Department of Finance (DOF) submitted a Finance Letter requesting the addition of Control Section 4.04, which would authorize the Director of Finance to reduce General Fund items of appropriation by up to a total of \$46.3 million. The reduction to any department could not exceed half of the funding provided for the 2007-08 General Fund price increase (the annual budget adjustment for the projected increase in the cost of operating expenses and equipment). The language also limits the reduction to the amount needed to eliminate any state operating deficit in 2007-08, as determined by the Director of Finance. The proposed language exempts the Legislature, Constitutional Officers, and the Judicial Branch from this reduction.

This request resulted from the Administration's desire to offset the cost of a January 18th arbitration award in a compensation dispute between the California Correctional Peace Officer's Association and the Department of Personnel Administration, costing \$46.3 million. The Governor's budget had identified a net operating surplus of \$20 million in 2007-08. DOF contended that without this additional reduction, the General Fund would have a net operating deficit in 2007-08.

Control Section 4.05: \$100 million Unallocated General Fund Reduction

This Control Section in the Governor's budget requires a one-time \$100 million unallocated reduction for state agencies' General Fund appropriations. The Director of Finance could provide Agency Secretaries with target amounts, and the secretaries would provide the director with recommended reductions. The director would determine reductions directly for departments not reporting to a secretary, and would make the final decision on all reductions.

Limits on Reductions and Credits for Other Savings. General Fund savings credited to another fiscal year also could be counted towards the \$100 million, as could savings in special funds that would revert to the General Fund in 2007-08. The language places a 20-percent maximum on reductions to any state operations item or to any program or project or function scheduled in that item; and a 5-percent limit on any local assistance appropriation or scheduled program, project, or function in that item.

Exemptions if Reduction Would Have Program Impact. The language exempts the following entities from the reductions: Higher Education; the Judicial Branch, the Legislature, Legislative Counsel Bureau, Constitutional Officers, Debt Service, Health and Dental Benefits for Annuity, Augmentations for Contingencies and Emergencies, and Equity Claims before the California Victim Compensation and Government Claims Board. *However, these exemptions would not apply if the Director of Finance determined that the savings would not negatively impact program needs as provided for in the enacted budget or other existing law.*

Report. The Director of Finance will report the following information to the Legislature by February 15, 2008:

1. Specific reductions approved.
2. Whether the reduction is one-time or ongoing.
3. A description of programmatic effects.
4. Positions affected.
5. Any other information needed to fully disclose the impact of reductions.

Legislative Analyst Recommends Rejecting 4.04 and Deleting 4.05

The Legislative Analyst's Office (LAO) argues that these provisions are unlikely to achieve their targeted levels of savings and that they represent a significant delegation of the Legislature's authority.

Reductions Reflect Administration's—Not Legislature's—Priorities. Any unallocated reduction authority given to the administration will expose legislative priorities to reductions. An administration naturally will protect its own priorities and sacrifice programs that it deems less important. For example, in the health area, previous reductions have targeted a prostate cancer treatment program and Medi-Cal antifraud activities—both of which were priorities of the Legislature.

Savings Already Counted. Over the past few years, the state budget has included a variety of control sections similar to the ones proposed for 2007-08. Based on recent experience, LAO estimates that only a fraction of the assumed budget savings would be a net benefit to the state's bottom line. For instance, in 2006-07, more than half (\$117 million) of the \$200 million in savings attributed to Control Section 4.05 was from declining debt service on loans and general obligation bonds. Another \$24 million was attributed to lower-than-expected usage of a health program. These types of savings occur "on the natural" and are already captured in the \$340 million of "unidentifiable savings" assumed in the budget. Thus, a significant amount of the savings attributed to these control sections is likely to be double counting.

Other Cuts Will Lead to Future Shortfalls. Many of the midyear reductions that have been implemented in the past have been done with minimal detail provided to the Legislature as to how departments are going to absorb the reductions. Often months or years later, the Legislature discovers that programs that were reduced are no longer functioning as expected. In many of these cases, departments come forward with requests for additional funding in the same or future years to make up for the reductions. For example, the 2007-08 budget contains a \$3.2 million request from the Department of Veterans Affairs for equipment purchases. The department reports its entire equipment budget was eliminated through reductions in prior years. Similarly, it is unclear how the Department of Corrections and Rehabilitation will absorb a \$31 million reduction in 2007-08 through Control Section 4.04—given that the department has experienced budget shortfalls of more than \$100 million every year since 2000-01.

Recommend Specific Proposals Rather than Unallocated Reductions. Given recent experience with similar control sections and the loss of legislative authority they require, LAO recommends that instead of proposing unallocated reductions, the administration should identify specific proposed savings in departmental budgets. This would allow the Legislature to understand any programmatic impact from the reductions and protect its own priorities.

COMMENTS

- 1) The DOF should explain how it intends to implement the unallocated reductions in CS 4.05:
 - a) What priorities would apply?
 - b) Why hasn't DOF had the agencies go through this drill already and present specific reductions?
 - c) How will DOF prevent double-counting of savings already assumed under the unidentifiable savings assumption?
 - d) Based on the language in the Control Section, could the Director of Finance impose reductions on exempted entities (such as the Judicial Branch and the Legislature) solely based on the *director's* finding that the reductions would not have a programmatic impact?
 - e) Why does the report call for an identification of whether reductions are one-time or ongoing if they are all supposed to be one-time?
 - f) Can DOF assure that reductions to the Franchise Tax Board will not result in revenue reductions? If so, then why not also apply the reductions to the Board of Equalization?
- 2) The administration's methodology for calculating operating surpluses/deficits is flawed. It excludes from spending all major one-time or temporary expenses, even though the state *always* has some one-time and temporary expenses every year. Neither does it include any provision for contingencies and emergencies (other than the placeholder \$49 million in the budget), even though these costs generally run hundreds of millions of dollars annually. Consequently, focusing on making a few tens of millions of dollars of additional cuts to achieve a chimerical operating balance is largely a public relations exercise.
- 3) DOF should explain why it is proposing to delete the remaining half (\$6.4 million) of the budgeted price increase for departments in the Health and Human Services Agency.

Action Should Await May Revision. The May Revision will provide updated budget revenue and spending estimates in which to evaluate the need for the reductions proposed in these control sections.

CONTROL SECTION 4.26 ELIMINATION OF BOARDS OR COMMISSIONS

This Control Section proposed in the Governor's budget authorizes the Department of Finance to reduce budget appropriations to the following five boards and commissions that the Governor proposed for elimination:

- 1) Consumer Power and Conservation Financing Authority
- 2) Electricity Oversight Board
- 3) Quality Education Commission
- 4) Heritage Preservation Commission
- 5) Public Library Construction and Renovation Board

COMMENTS

The elimination of these entities has not been included in Subcommittee actions. Instead, these proposals should be considered in the policy process. Accordingly, this Control Section is unnecessary and should be deleted. No General Fund savings were associated with this Control Section.

**CONTROL SEC. 35.60 TRANSFER OF BUDGET STABILIZATION ACCOUNT
TO THE GENERAL FUND**

Proposition 58, approved by the voters in the March 2004 primary election, enacted a balanced budget requirement, established a process for the Governor to declare a fiscal emergency and call the Legislature into special session to take mid-year corrective action to keep the budget in balance, and also created the Budget Stabilization Account.

Budget Stabilization Account (BSA). The primary purpose of the BSA is to act as a multi-year budget stabilization tool. The California Constitution requires 1 percent of estimated General Fund revenues must be transferred to the BSA in 2006-07, 2 percent in 2007-08, and 3 percent in 2008-09 and annually thereafter, until the BSA reaches the greater of \$8 billion or 5 percent of General Fund revenues. The constitution allows the Governor to suspend transfers to the BSA, but the Governor must act to do so by June 1 of the *prior* fiscal year. Also, while the Economic Recovery Bonds (ERBs) are outstanding, half of the annual transfers to the BSA (up to a cumulative total of \$5 billion) are appropriated to accelerate their repayment.

The constitution provides that once funds are in the BSA they may, by statute, be transferred into the General Fund. The intent was to require a specific action by the Legislature in order to reach into the BSA, so that it would be separate from the regular General Fund reserve.

The Governor's budget estimates that about \$2 billion will be transferred to the BSA in 2007-08, of which half would go towards repayment of the ERBs and the remainder (\$1 billion) would remain in the BSA. The total balance in the BSA would be about \$1.5 billion (after the debt service payment), including a carryover balance from the current year of \$472 million. In addition, the Governor's budget projects a General Fund reserve of \$590 million.

Control Section 35.60 would allow the administration to transfer any amount from the BSA to the General Fund in order to maintain a "prudent" General Fund reserve, as determined by the Director of Finance.

COMMENTS

Cake and Eat It Too. The administration is trying to have it both ways. If the Governor feels it necessary to have a larger reserve in the General Fund itself, then he can suspend the BSA transfer. Instead, the administration is asking for this language, which would effectively make the BSA part of the regular General Fund reserve from the administration's point of view. The result would be inconsistent with the intent of Proposition 58.

Bypasses Legislature. If General Fund revenues fall short during the year, the proposed control section would enable the administration to use BSA funds to maintain its spending priorities without Legislative approval, so that the Governor could direct the funds to protect his spending priorities, but not necessarily those of the Legislature. Instead, any use of the BSA should require enactment of legislation. Eliminating Control Section 35.60 would accomplish this.

The Legislature also deleted this proposal in the 2006-07 Budget.