AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION

ASSEMBLYMEMBER TOM DALY, CHAIR

TUESDAY, MARCH 19, 2013
1:30 P.M. - STATE CAPITOL ROOM 447

ITEMS TO BE HEARD

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7730 FRANCHISE TAX BOARD

INFORMATIONAL ITEM 1: OVERVIEW OF MAJOR PROGRAMS

The Franchise Tax Board will provide an overview of major programs.

PANELISTS

- Franchise Tax Board
- Legislative Analyst's Office
- Department of Finance

BACKGROUND

The Franchise Tax Board (FTB) administers the personal income tax and the corporation tax programs, the largest and third-largest contributors to the state's revenue, respectively. The department also performs some non-tax collection activities, such as the collection of court-ordered payments, delinquent vehicle license fees, and political reform audits. The FTB is governed by a three-member board, consisting of the Director Finance, the Chair of the Board of Equalization, and the State Controller. An executive officer, appointed by the board, manages the daily functions of the department. The Governor’s Budget proposed expenditures of $750.2 million ($719.1 million General Fund, 10.6 percent increase) and 5,771.2 positions for FTB.

ISSUE 1: AUTOMATED PROPOSALS

The Governor's Budget contains two budget change proposals (BCPs) for FTB that affect automated systems.

PANELISTS

- Franchise Tax Board
- Department of Finance
- Legislative Analyst's Office

BACKGROUND

The Governor's budget contains two budget change proposals (BCPs) for FTB that affect automated systems:

1. ***Enterprise Data to Revenue (EDR).*** The first BCP pertains to FTB's EDR technology to update and enhance FTB's tax systems. It provides a new tax return processing system, an enterprise data warehouse, a taxpayer folder to access data, and other services for taxpayers and customers. The EDR project is the first of several of FTB's information technology (IT) projects that will address modernizing the tax systems technology environment. The EDR project has a project cost of $689 million which includes $339 million in payments to an outside contractor and $290 million in FTB costs for personal services. FTB anticipates that the project revenues will fully cover the project costs. The contract is designed so that contractor's portion of the costs is being paid based solely on the revenue that the project generates.

   The project is scheduled for completion in 2016 and it is anticipated that the State's General Fund will continue to see $1 billion in annual General Fund revenue collections.

2. ***Processing Unit Capacity.*** The second BCP relates to processing capacity, memory storage and software upgrades to FTB's mainframe computing systems. FTB collects over 65 percent of the State's General Fund revenue and manages several non-tax debt programs. FTB relies on a full service data center to provide mainframe and distributed systems access and the necessary operating capacity for FTB to administer its programs successfully. In 2011-12, on average, FTB's data center processes 20 million online transactions and 242,000 batch jobs per month. During April, FTB processes approximately 26.2 million online transactions and about 288,000 batch jobs.

FTB programs rely heavily on the completion of night batch processing window in order to provide updates to the legacy systems. The legacy systems include taxpayer information, business entities, and non-tax debt. Industry guidelines recommend operating at less than 90 percent of available general processor capacity in order to maintain acceptable demand levels and maintain an efficient information system network. Based on the projected workload indicators, FTB expects 12 percent workload growth annually. The current system expects to be operating at 93 percent in 2012-13 and 104 percent in 2013-14.

STAFF COMMENTS

1. EDR Project. The EDR project is in its third year of its contract and appears to be exceeding project expectations. In 2011-12, revenue generated by the project exceeded the project projections by over 10 percent. Projected revenue was $37.4 million compared to the actual figure of $75.8 million. EDR revenue is anticipated to increase over time. Revenue generated from the EDR project is 2013-14 is anticipated to be $261.5 million in General Fund. Revenue is expected to increase to $684.6 million in 2014-15.

2. Processing Unit Capacity. For the processing capacity unit increase the Subcommittee may wish to ask the Board about the following issues:

- When was the last time the Board upgraded its processing capacity, memory storage, and software upgrades?
- How will the improvements to the EDR project interact with this proposal?
- What will the ongoing costs of $700,000 cover?

ISSUE 2: PROPOSED STATUTORY CHANGES TO VARIOUS LAWS

The Administration is proposing the following three trailer bills affecting the revenue and taxation code.

PANELISTS

- Department of Finance
- Franchise Tax Board
- Board of Equalization

BACKGROUND

The Administration is proposing the following three trailer bills affecting the revenue and taxation code:

1. ***Attorney's Fees.*** California's Code of Civil provides a prevailing party whose litigation results in the enforcement of an important public interest may be awarded attorney's fees. This statute was adopted to ensure that the private attorney general doctrine applied for state constitutional and statutory issues, similar to the federal level. SB 813, Chapter 498, Statutes of 1983 was enacted to conform with federal law that added a new attorney fee section to the Internal Revenue Code (IRC) to make the new IRC provision exclusive for federal tax cases. However, SB 813 failed to explicitly state it was to be an exclusive remedy.

   The trailer bill language would make the Revenue and Taxation code the exclusive remedy in tax cases for sales tax, corporation tax, and personal income tax. It also would add language to several other parts of the revenue and taxation code, to make the exclusive remedy for tax cases under those parts. The bill would only affect court proceedings that have not been filed prior to the effective date.

2. ***Triple Flip.*** The Governor's trailer bill relating to the triple flip is proposed by the Administration to prepare for the end of the triple flip. The Governor's Budget proposes trailer bill language to outline a process to provide compensation to cities and counties when the triple flip mechanism is no longer needed to pay for the Economic Recovery Bonds (ERB). The Governor anticipates that the ERBs will be paid off by the second quarter of 2016.

   The current triple flip statute does not allow for cities and counties to be compensated for the full amount that they did not receive as a result of the 0.25 percent reduction in the Bradley-Burns tax rate during the period in which that rate was reduced. This trailer bill would allow for cities and counties to be compensated based on the actual amount that was remitted to BOE while this rate was in effect.

3. ***Net Final Payment Accrual.*** The final trailer bill language relates to net final payment accrual method. Control Section 35.50(e) of the 2012-13 Budget Act, stated that a significant portion of the additional 2012 income tax revenues from Proposition 30 will be "accrued" or attributed to the 2011-12 fiscal year. This accrual method was named the net final payment accrual methodology by the Department of Finance. Accrual method changes do not change the amount of revenue collected or assumed to be collected by the state, but rather changes the fiscal years to which revenue is attributed in the state's budgetary accounting system.

   This proposal by the Administration was a result of the anticipation of the passage of Proposition 30. Proposition 30 was approved in November 2012 and applies higher income tax rates for upper-income taxpayers retroactively. Therefore the state planned to attribute part of the Proposition 30 revenues related to tax year 2012 to the 2011-12, since some of the taxable income involved was generated during 2011-12.

   This accrual method would reduce the Proposition 98 minimum guarantee in 2012-13 because it lowers the General Fund revenue growth from 2011-12 to 2012-13. Without the accrual method, the Proposition 98 guarantee would be calculated at a much higher rate.

STAFF COMMENTS

1. Attorney's Fees. The Governor's proposed trailer bill language on attorney fees proposes to amend various parts of the state Revenue and Taxation Code applicable to attorney's fee.

There have been four cases relating to attorney's fees in the past ten years which have cost the state over $2 million. There are no immediate fiscal impacts to the 2013-14 budget and future budget implications are unknown. The Subcommittee may want to consider whether or not this language is more appropriate to go through a policy committee versus a budget trailer bill.

2. Triple Flip. This triple flip trailer bill language would outline a process for future payment of the triple flip, which is expected to end in the second quarter of 2016. The Subcommittee may want to consider adding placeholder language to the trailer bill that includes a date as to when the repayment to cities and counties should be completed.

3. Net Final Payment Accrual. The use of the net final payment accrual methodology is a complicated process. The Legislature currently has the option to decide whether or not the accounting method should be used on a case by case basis. For the implementation of Proposition 30, using the accounting methodology to attribute taxes to the appropriate year makes sense for 2011-12 and 2012-13. But after that it creates a very complex system where some funds are calculated under the current system and other funds will be calculated under the net final accrual methodology.

For the short term, the Legislature should consider rejecting the trailer bill language and continue to use its discretion through the budget process to decide whether to use net final accrual methodology. For the long term, the Legislature should consider researching ways to help improve the state's budgetary process that will provide more accuracy in forecasting and transparency in government financing.

0840 STATE CONTROLLER'S OFFICE

INFORMATIONAL ITEM 1: 21ST CENTURY PROJECT

In February, the State Controller's Office (SCO) halted MyCalPAYS project, an IT project to replace the existing statewide payroll system used by state employees. SCO will provide a status update and discuss next steps for the project.

PANELISTS

- State Controller's Office
- Legislative Analyst's Office
- California Technology Agency
- Department of Finance

BACKGROUND

In 2004, the SCO proposed the 21st Century Project (TFC), a new IT project to replace the existing statewide human resources management and payroll systems used to pay state employees. The new system was designed to replace the "legacy systems" which were developed more than 30 years ago. The new system, known as MyCalPAYS, was intended to manage processes such as payroll, benefits, and timekeeping in more central and cost efficient manner than the legacy systems.

The SCO is responsible for issuing pay to the state's 294,000 employees statewide, and therefore responsible for the implementation and management of the new system. The SCO developed a two-phase procurement process that would allow the agency to first contract to purchase commercial software and second to contract with a vendor to modify the software to meet the state's systems integration needs. Early on the project had delays that extended the schedule by two years and increased project costs from $130 million to $180 million. In 2009, SCO terminated the original integration services contract.

In 2010, a new integration services contract was procured and project schedule and costs were revised. The schedule was extended to October 2012 and the total costs rose from $180 million to $283 million. Implementation of the project was supposed to occur in five phases or pilots. These early pilots were designed to integrate a small number of employees into the system in order to test the system prior to the full launch of the system. A number of challenges occurred with the early pilots and as a result SCO sent a cure notice to the primary vendor in order to make changes. Once again the project costs increased to $373 million and the schedule of completion moved to September 2013.

In February 2013, the SCO terminated its contract with the vendor citing inaction by the vendor in response to the cure notice and a lack of confidence that the project could be completed by the vendor. The California Technology Agency suspended further work on the project until a new plan could be created. For now, the SCO has reverted to the legacy system to administer payroll processing.

Roles and Responsibilities of the IT Projects Statewide. The California Technology Agency has the lead responsibility for various IT functions, including project oversight and risk management concerning major IT projects sponsored by other departments. The Department of General Services (DGS) has key responsibilities concerning the procurement of IT goods and services. In 2012, legislation was enacted AB 1498 (Buchanan), that requested that the Administration develop a plan for moving IT procurement authority from DGS to the Department of Technology. The bill also discussed continued Legislative efforts to consolidate responsibility for major IT project oversight and risk management in a single place.

STAFF COMMENTS

There are serious concerns associated with moving forward with this project. To date, the project has cost the state $262 million of the estimated $373 million project cost.

The Legislative Analyst's Office recommends a number of steps the state should consider before moving forward with the project including an independent assessment by the Technology Agency, examining alternatives to the new payroll process, and evaluating the existing legacy process.

The Governor's 2013-14 Budget did not include a budget proposal for the 21st Century Project (TFC), due to increasing problems that the SCO was having with the project.

The Subcommittee may wish to ask the SCO and the Technology Agency the following issues:

- What do other states currently use for their payroll systems?

- Moving forward, what role should the Technology Agency play in the procurement process for large projects such as MyCalPAYS?

ISSUE 1: AUDIT PROPOSALS PERTAINING TO SCO

The budget proposes two BCPs pertaining to the SCO.

PANELISTS

- State Controller's Office
- Department of Finance
- Legislative Analyst's Office

BACKGROUND

The budget proposes the following two BCPs pertaining to the SCO:

1. ***Payroll Audits.*** The first BCP is related to an issue that arose from a recent internal audit at the California Department of Parks and Recreation (Parks) that uncovered a vacation buyout program that was instituted at Parks without authorization from Parks management or the Department of Human Resources (CalHR). According to the SCO, this recent activity stresses the need for department level payroll process audits to be reinstated on the SCO legacy system.

   These specific types of audits that focus on the controls existing at the department and agency levels were eliminated in the 1980s according to the SCO. The BCP would reinstate positions in order to start performing these payroll audits.

2. ***Special Fund Audits.*** The second BCP also pertains to Parks and the fact that Parks had been significantly underreporting available fund balances for two special funds to DOF. While Parks reported accurate amounts to the SCO, it understated the available amounts reported to DOF. The Governor directed DOF to undertake a fund-by-fund review of more than 500 special funds.

   The findings concluded that the state needs to implement additional policies and procedures to address differences in the balances of the special funds reported to DOF and SCO. Moving forward DOF and SCO will coordinate their efforts and report annually to the Legislature.

   SCO does not have staff to handle the new workload. Currently, to implement the policy, SCO has hired temporary staff and redirected existing staff.

STAFF COMMENTS

1. Payroll Audits. The Subcommittee may wish to ask SCO the following with regard to the audits to the legacy system:

- What types of audits are currently performed on the legacy system?
- How much staff resources are devoted to those audits? Would any of those audits have caught the vacation buyout program that was instituted at Parks?
- How will the pause in the 21st Century Project affect future audits of the legacy system?

2. Special Fund Audits. Additionally, for the audits related to the special funds, the Subcommittee may consider asking the following:

- Will the Financial Information System for California (FI$Cal project), include capabilities to generate special fund reports in the future in order to accommodate the need for future audits?

0950 STATE TREASURER'S OFFICE

INFORMATIONAL ITEM 1: OVERVIEW OF GENERAL OBLIGATION DEBT, COMMERCIAL PAPER AND STATE CREDIT RATING

The State Treasurer's Office and the Department of Finance will provide a presentation on the State's General Obligation Debt and Commercial Paper, and an update on the California's recent credit rate upgrade.

PANELISTS

- State Treasurer's Office
- Department of Finance
- Legislative Analyst's Office

BACKGROUND

The State uses general obligation bonds (GO bonds) to borrow funds for spending – primarily for infrastructure and other capital investments. Bonds must be approved by voters and bond proceeds are either continuously appropriated or require an appropriation from the Legislature. All bond debt service is continuously appropriated and not appropriated in the annual budget bill. According to the State's Treasurer's Office, the state has $79.6 billion in outstanding GO bond debt and another $33.2 billion in bonds are authorized but remain unissued.

The Governor's Budget includes $5.1 billion in General Fund costs for GO bond debt service and related costs, or a total of $6.6 billion when the debt service costs of the Economic Recovery Bonds are included. Of this amount, $1.1 billion in debt costs are scheduled to be funded from special funds.

0971 CALIFORNIA ALTERNATIVE ENERGY AND ADVANCED TRANSPORTATION FINANCING AUTHORITY

ISSUE 1: IMPLEMENTATION OF SB 1128 (SALES AND USE TAX EXCLUSION FOR ADVANCED MANUFACTURING EQUIPMENT)

The budget includes a request for a three-year limited-term position for the California Alternative Energy and Advanced Transportation Financing Authority CAEATFA to address the workload associated with the implementation of SB 1128 (Padilla), Chapter 677, Statutes of 2012. It also includes a request for budget bill language to extend the repayment schedule to 2015-16 in order to help absorb the start-up and early implementation costs of SB 1128.

PANELISTS

- California Alternative Energy and Advanced Transportation Financing Authority
- Department of Finance
- Legislative Analyst's Office

BACKGROUND

In 2010, SB 71 created a sales and use tax exclusion (STE) program for advanced transportation and alternative source manufacturing in California. In 2012, additional legislation, expanded CAEATFA's STE program to include advanced manufacturing with annual cap of $100 million available for STE awards. The goal of the program is to promote the creation of California based manufacturing, businesses, and jobs that are aimed at reducing greenhouse gases, air and water pollution, and energy consumption.

In 2010, SB 77 (Budget and Fiscal Review Committee), Chapter 15, Statutes of 2010 and in 2011, AB 14 X1 (Budget Committee), Chapter 9, Statutes of 2011 provided CAEATFA with additional statutory authority to provide financial assistance to encourage energy efficiency efforts. Under AB 14 X1, CAEATFA developed a loan loss reserve program to assist financial institutions in making loans to homeowners in the state for residential energy efficient and renewable energy projects.

A number of projects have been delayed and were granted extension of the 25 percent purchase requirement. The projects delays in purchasing equipment have led to a delay in CAEATFA receiving administrative fees, which in turn has affected CAEATFA's ability to determine an accurate timeframe to repay the loan by the Renewable Resources Trust Fund.

With the passage of SB 1128, the type of eligible projects under CAEATFA's authority to provide sales and use tax exclusion beyond equipment and machinery used to produce advanced transportation and alternative source products to include advance manufacturing. CAEATFA may now additionally award projects if the project includes advanced manufacturing, thereby helping to grow the population of projects and help CAEATFA recover administrative fees to repay the loan at a faster rate.

STAFF COMMENTS

Staff recommends adopting the Governor's proposal for additional staff and including budget bill language that would extend the term of the loan to 2015-16. The Subcommittee may wish to consider requiring CAEATFA to report back to the Legislature on an annual basis on the number of projects and progress on the repayment of the loan.

0968 CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE

ISSUE 1: ALLOCATION UNIT STAFF AUGMENTATION

The Governor's Budget includes $118,000 for one permanent position for the Allocation Unit to carry out core functions and administer federal and state mandates of the Low Income Housing Tax Credit (LIHTC) program.

PANELISTS

- California Tax Credit Allocation Committee
- Department of Finance
- Legislative Analyst's Office

BACKGROUND

As part of its activities, the California Tax Credit Allocation Committee (CTCAC) administers both a federal and state low-income housing tax credit program that encourages private investment in rental housing development for low and very low-income families and individuals. CTCAC has helped fund the construction of over 326,000 units since its inception and more than 17,000 last year. The average number of competitive applications reviewed and recommended by staff was 75-80 per year. In 2011, CTCAC states that the number increased to about 100-105 per year. By law CTCAC is required to conduct at least three application reviews for each project through the entire development process and then a final review prior to the final step. Additionally, the State Controller's Office reviewed CTCAC internal process and recommended that CTCAC build in additional review on key tasks associated with the initial application review process. SCO recommended improvements to CTCAC's final project auditing practices and systems. Staff workload has increased over the past years but the staffing levels have remained the same.

STAFF COMMENTS

The Subcommittee may wish to ask CTCAC the following:

- How has increased workload been addressed in prior years?

0860 STATE BOARD OF EQUALIZATION

INFORMATIONAL ITEM 1: OVERVIEW OF MAJOR PROGRAMS

The Board of Equalization will provide an overview of the BOE's major programs.

PANELISTS

- Board of Equalization
- Department of Finance
- Legislative Analyst's Office

BACKGROUND

The State Board of Equalization (BOE) is comprised of five members: four members each elected specifically to the Board on a district basis, plus the State Controller. The BOE administers the sales and use tax (including all state and local components), oversees the local administration of the property tax, and collects a variety of excise and special taxes (including the gasoline tax, insurance tax, and cigarette and tobacco products taxes) and various fees (including the underground storage tank fee, e-waste recycling fee, and fire prevention fee). The BOE establishes the values of state-assessed property, including inter-county pipelines, railroads, and regulated telephone, electricity, and gas utilities. The BOE also hears taxpayer appeals of FTB decisions on personal income and corporation taxes.

The Governor’s Budget proposes resource support of $555.9 million ($313.5 million General Fund), and 4,847.1 positions for the BOE in fiscal year 2013-14, as shown in the following table. The budget proposes a total funding increase of $28.7 million (5.2 percent), and General Fund support increase of $16.3 million (5.2 percent), compared with spending estimates for the current year. Proposed staffing in the budget would increase by 135.0 positions (2.8 percent) from the current-year estimate.

Fund Source (millions)	2011-12 Actual	2012-13 Projected	2013-14 Proposed	BY to CY Change	% Change
General Fund	$274.1	$297.2	$313.5	$16.3	5.2
Other Funds	63.8	78.8	82.3	3.5	4.3
Reimbursements	136.5	151.2	160.1	8.9	5.6
Total Expenditure	$474.4	$527.2	$555.9	$28.7	5.2
Positions	4,257.4	4,712.1	4,847.1	135.0	2.8

ISSUE 1: ADDITIONAL RESOURCES FOR BOE PROJECTS

The Governor's Budget includes three budget change proposals for the Board of Equalization.

BACKGROUND

The Governor's budget includes the following three budget change proposals for the Board of Equalization:

1. ***eReg.*** The budget proposes additional resources to enhance the BOE's online registration system (eReg). Currently, the BOE's eReg system does not allow tax and fee payers to electronically update and maintain their account. The additional resources will allow taxpayers to register online and make account maintenance adjustments that currently are handled by BOE staff.

2. ***Fuel Tax Swap.*** The Fuel Tax Swap (AB 6 X8 (Budget Committee), Chapter 11, Statues of 2009-10 Eighth Extraordinary Session, and SB 70 (Budget and Fiscal Review Committee, Chapter 9, Statutes of 2010, reduced the state portion of sales and use tax applied to the Motor Vehicle Fuel, increased the MVF excise tax rate, and imposed a MVF floor stock tax on gasoline. In addition, the state portion of the sales and use tax on diesel fuel increased and the excise tax on diesel fuel decreased. Beginning July 1, 2012, the state's excise tax on diesel fuel was adjusted to offset the additional revenue generated by the increased sales tax rate imposed on diesel fuel. The law required that the diesel fuel rate be reviewed and adjusted yearly to maintain revenue neutrality.

   In 2010-11, BOE submitted a Spring Finance Letter (SFL) #1 "Fuel Swap" and obtained resources to implement the Fuel Tax Swap. BOE originally requested permanent staff, the SFL authorized limited term positions. These positions are set to expire on June 30, 2013.

3. ***Joint Operations Center.*** The JOC project combines staff, data, and expertise from both federal and state governments to effectively identify fuel taxes under-reporting, non-reporting and trends leading to evasion. These pooled resources provide benefits to both state and federal fuel compliance efforts.

STAFF COMMENTS

There has been a pattern of increased staff provided for the expansion of the e-Services project over the past four years. The BOE was funded $4,670,000 and 3.0 positions in 2008-09, $4,384,000, and 5.0 positions in 2009-10, $2,005,000 and 7.5 positions in 2010-11, and $1,826,000 in 2011-12.

The Subcommittee may wish to inquire as to when the enhancements to the e-Services will lead to a decline in the number of positions needed to run the automated systems?

9210 LOCAL GOVERNMENT FINANCING

ISSUE 1: AID TO LOCAL GOVERNMENT—SAN MATEO AND AMADOR COUNTIES

The budget proposes $1.8 million in backfill to Amador and San Mateo counties due to circumstances arising from the triple flip that occurred in connection with the state's issuance of Economic Recovery Bonds (ERB) and the Vehicle License Fee (VLF) swap. Similar to past years, the shortfall only affects a small number of counties. The 2012-13 Budget Act provided $1.524 million to backfill Amador County.

PANELIST

- Department of Finance
- Legislative Analyst's Office

BACKGROUND

In 2004, two policies shifted local property tax from schools to cities and counties, requiring the state to backfill schools for the property tax revenues.

- The first of these events was the "triple flip," related the state issuance of the ERBs. To pay debt service on the bonds and retain the overall sales tax rate, the local sales tax for cities and counties was reduced by ¼ cent and the State sales tax was increased by ¼ cent to repay the ERBs. To hold cities and counties harmless, property tax was redirected from schools to cities and counties. The ¼ cent rate is to be restored when the ERBs are repaid. It is anticipated that the ERBs will be repaid by 2016.

- The second event was the enactment of the "swap" which provided local property taxes to cities and counties instead of a state backfill to make up for the VLF reductions in 2004. The goal was to provide a more reliable funding mechanism to backfill cities and counties for the local revenue cut by the State when the VLF tax on motor vehicles was reduced from 2.0 percent to 0.65 percent.

As a result, cities and counties receive increased property taxes from two sources: first, the countywide property tax Educational Revenue Augmentation Fund (ERAF) and, second (if ERAF resources are not sufficient), base K-14 district property tax revenues. State law specifies, however, that "basic aid" K-14 district property tax revenues are not available for allocation to cities and counties for this purpose. Basic aid districts are those that receive sufficient funding from the local property tax and do not receive resources from the state for general educational purposes.

In Amador and San Mateo Counties, the cost of offsetting the triple flip and VLF swap exceeded the funds in their ERAFs. Because every school district in these counties is basic aid, no K-14 district property tax revenues were available to shift to the cities and counties. Since current law does not allow additional property tax shifts to make these counties whole, the estimated loss for the two counties in the Governor's budget proposal is $1.8 million.

STAFF COMMENTS

With the triple flip and VLF swap, local governments have benefited from the more robust growth in property taxes, compared to the growth in sales tax and the VLF. But in cases like Amador and San Mateo, when property taxes cannot be shifted, the higher growth rate leaves these localities falling short.

The Legislative Analyst's Office discusses two ways to compensate for the insufficient ERAF. The first is to fund the shortfall consistent with Governor's January Budget. The rationale is because insufficient ERAF is a not a problem created by action or inaction of a local government, it is a problem that was unforeseen at the time of the swap. The second way to compensate would be to not fund the insufficient ERAF. The argument can be made that local governments benefitted more from the growth rates in property tax versus sales tax and therefore are receiving more funds from property taxes.

Since the release of the Governor's Budget, additional information shows that Alpine County also may be in a similar situation as Amador and San Mateo Counties. The final insufficient ERAF amounts will not be known until the counties receive their 2011-12 tax reports from the Department of Education, which is expected sometimes this spring. It is anticipated that the cost will increase slightly. The Subcommittee should consider waiting until final estimates are received before moving forward with this item.