

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

Assemblymember John Dutra, Chair

TUESDAY, APRIL 27, 2004
STATE CAPITOL, ROOM 447
1:30 P.M.

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ITEM 0860 STATE BOARD OF EQUALIZATION

The Board of Equalization (BOE) administers state and local sales and use taxes. The board also collects a variety of business and excise taxes and fees, including the gasoline tax and taxes on alcoholic beverages and on cigarettes and tobacco products. In 2004-05, the board will collect an estimated \$46 billion of state and local tax revenue. The board also has a number of other significant tax administration roles. It oversees the administration of the property tax by county assessors and assesses property owned by public utilities. The Board's elected members also serve as an appellate body for decisions of the Franchise Tax Board concerning personal income and bank and corporation taxes.

The budget proposes total spending of \$326.8 million for the board in 2004-05 (\$194.4 million General Fund). Total spending declines slightly (by \$1.4 million) while General Fund spending remains essentially flat compared with 2003-04. Proposed staffing totals 3,462 personnel-years (PYs), a slight decline of 23 PYs (0.7 percent) compared with the current year.

**State Board of Equalization
Governor's Budget
Funding and Staffing
2002-03 through 2004-05
(Dollars in thousands)**

	CURRENT YEAR (Estimated)		BUDGET YEAR (Proposed)		CHANGE FROM 2003-04			
	2002-03	(PY)	2003-04	(PY)	2004-05	(PY)	Dollars	(PY)
PROGRAMS								
Sales and Use Tax	\$255,134	3,059	\$258,061	2,861	\$258,879	2,819	\$818	-42
Alcoholic Beverage Tax	1,845	19	1,908	18	1,744	18	-164	0
Cigarette and Tobacco Products Tax	9,358	74	9,196	66	7,976	67	-1,220	1
Cigarette and Tobacco Products Licensing Program	-	-	5,598	41	8,161	81	2,563	40
Motor Vehicle Fuel License Tax	4,627	38	4,242	39	3,140	24	-1,102	-15
Diesel and Use Fuel Tax	17,226	160	18,095	151	16,340	149	-1,755	-2
Property Tax	14,140	162	15,616	162	15,616	159	0	-3
Other	13,992	156	15,540	146	14,964	145	-576	-2
TOTAL PROGRAMS:	\$316,322	3,668	\$328,256	3,484	\$326,820	3,462	-\$1,436	-22
General Fund	\$195,894		\$194,022		\$194,393		\$371	

Note: Issues resulting from the Assembly Budget Oversight Meetings will be discussed at a subsequent hearing.

ISSUE 1: MINIMIZING REVENUE LOSS FROM STAFF REDUCTIONS

The Legislative Analyst's Office (LAO) recommends reallocating staffing to regain \$20 million of General Fund (GF) revenue in 2004-05.

BACKGROUND

According to the LAO, under Section 4.10 of the 2003-04 Budget Act, the administration required the BOE to absorb ongoing annual budget reductions of approximately \$16 million and 141 positions. The BOE has chosen to make these reductions in a manner that minimizes the impact on taxpayer services (as opposed to revenue activities), and avoids any staff layoffs. Many of the positions that are proposed to be eliminated or not filled are revenue-producing, primarily due to their relationship to audit and collection activities. In addition, while some other positions scheduled to be eliminated are not directly related to revenue losses, they are a component of overall tax processing—the "tax pipeline"—and thus could have an indirect impact on revenues.

Of the 141 positions being lost, 91 have a direct revenue impact. The reduction in revenues included in the Governor's budget related to this loss of positions is estimated in 2004-05 to be \$35.5 million for all funds and \$27 million for the General Fund. Additional local government losses stemming from sales and use tax (SUT) declines would also occur as a result of these staff reductions.

LAO Recommendation. The LAO estimates that a temporary shift of 20 positions from taxpayer services to audit and collections would result in additional revenues of approximately \$6 million in 2004-05. In addition, LAO notes that the BOE has in the past shifted some staff resources from revenue activities to nonrevenue activities such as technology services and call centers and that moving a portion of these positions back revenue areas could generate as much as \$20 million in additional revenue. However, LAO also notes that these staffing shifts would likely have some negative impact on taxpayer services. For example, there might be delays in responding to inquiries or even mailing refund checks.

BOE Alternative Approach Restores Staff. The BOE developed an informal proposal for an augmentation of \$14.3 million (\$11.4 million GF). Of this amount, \$8.5 million would be used to pay unfunded costs of existing positions by reducing the budgeted salary savings requirement (from about 8 percent to 4 percent) and \$5.8 million would be used to augment by 100 positions (50 auditors and 50 collectors). The estimated total revenue increase from these augmentations would be \$59.4 million (including gains to local governments).

COMMENTS:

- The LAO and the board should provide additional information to the subcommittee regarding the negative effects of a staff redirection on taxpayer services or board support functions.
- The augmentation alternative has a revenue-to-cost ratio of 4.2, which is less than the standard 5-to-1 ratio generally required for revenue-enhancing augmentations. Also, it is not clear whether the ratio of the GF components of costs and revenues are the same as the overall ratio.

- It would seem to be worth exploring a combination approach to redirect some resources and possibly restore some funding and/or positions in order to maximize the revenue gains while minimizing adverse effects on taxpayer services and other critical functions.

ISSUE 2: A STAFF CUT FOR BOARD MEMBERS?

The LAO recommends that BOE board members' budget authority for personal staff be limited to actual budget expenditures made in 2002-03. This would result in a savings of \$1 million (\$0.7 million GF, \$0.3 million special funds) in 2004-05 and a reduction of 14 positions.

LAO points out that in 2002-03, professional board staff to the four district-elected board members totaled 38 positions, with annual expenditures of \$2.9 million. For 2003-04 and 2004-05, 52 positions and a total of \$3.9 million are budgeted. This represents an increase in expenditures of 36 percent, and LAO contends that tasks assigned to board member staff have not changed appreciably since 2002-03.

COMMENTS:

- BOE should explain the reason for the growth in the number of staff for board members, and why no reduction is proposed for 2004-05.

ISSUE 3: ELIMINATE CAP ON CHARGES TO SMALL LOCAL TAX DISTRICTS

The LAO recommends ending the cap on BOE collection charges to small local taxing districts for a GF savings of \$1.3 million.

BACKGROUND

The BOE collects and administers all state and local sales, use and transaction taxes, including various additional tax rates imposed by special taxing districts, cities and counties. As a general rule, BOE allocates the costs of the overall SUT program proportionately to all of the funds and local governments that benefit in proportion to the amount of revenue that they receive.

However, legislation adopted in 1998—Chapter 890, Statutes of 1998 (AB 836, Sweeney) - provides for an exception from this general rule. AB 836 caps the amount that BOE may charge smaller special taxing districts as a means of making these special taxes more financially feasible. The statute essentially requires that the state subsidize certain special taxing districts for their administrative costs.

LAO argues that these special taxing districts should be self-supporting, and that administrative costs of taxes that are approved by the voters or public bodies should be borne by them. Accordingly, LAO recommends that the Legislature end the caps on reimbursements for these administrative costs, reducing GF expenditures by \$1.3 annually and increasing cost reimbursements to BOE by the same amount.

COMMENTS:

- BOE should identify the local tax entities that currently benefit from the cap.

ISSUE 4: BOE AND FRANCHISE TAX BOARD (FTB) FIELD OFFICE CONSOLIDATION

BOE maintains 27 field offices throughout the state along with four out-of-state field offices. These 31 offices provide access to taxpayers for various information requests and technical assistance. In addition, the field offices are used for auditing and collection activities. The FTB also maintains 16 field offices throughout the state, some of which are co-located with BOE offices. Currently, the FTB is engaged in an ongoing effort to reduce its district offices and develop additional capacity for taxpayer assistance through more effective and efficient means—such as the use of the Internet or various forms of telecommunication. It is also considering additional steps to reduce field office expenses. However, LAO finds that a similar effort is not occurring at BOE. Consequently, LAO recommends that BOE investigate options for field office cost reductions similar to those being explored by FTB.

For example, LAO estimates that consolidation of certain closely located offices in the southern California area would result in annual savings in the range of \$500,000 to \$750,000 (largely through lease, furniture, and utility savings) without resulting in any revenue reductions. This could be coupled with additional taxpayer service and administrative activities provided through Internet or telephone access in order to minimize the impact on taxpayer services. Similarly, reductions in out-of-state offices could also occur.

LAO Recommends Report by BOE. LAO recommends adoption of the following supplemental report language:

The Board of Equalization (BOE) shall provide to the Chair of the Joint Legislative Budget Committee and the chairs of the fiscal committees of the Legislature by December 1, 2004, a report containing the following information: (1) unit costs of providing taxpayer services and audit and collection activities at the BOE's 27 field offices; (2) net annual budgetary benefits of consolidating or closing four BOE field offices (one in each BOE district); (3) estimated impact on all BOE-collected tax revenues from field office consolidations or closures identified in (2) above; (4) net annual benefits of reducing or eliminating an out-of-state office. Data provided shall include one-time and ongoing budgetary and revenue impacts.

ISSUE 5: APRIL FINANCE LETTER REQUESTS

The Department of Finance has requested the following adjustments to the BOE's budget:

1. Twice-Monthly Reporting for Cigarette and Tobacco Products Distributors – augmentation of \$53,000 (\$27,000 GF). This augmentation funds 0.5 PY and contract costs to implement the provisions of Chapter 867, Statutes of 2003 (AB 1666, Cogdill).
2. Department of Motor Vehicle (DMV) Fee Increase - augmentation of \$687,000 (\$550,000 GF). This augmentation reflects increased costs of the DMV to collect use tax on vehicle sales on behalf of BOE.

COMMENTS:

Both of these requests appear to allocate too large a share of costs to the GF. The GF receives only 11.5 percent of cigarette tax revenues, and the share of DMV costs assigned to the GF also appears high.

- BOE should explain the allocation of costs to the GF in both of these requests.

ISSUE 6: CONSOLIDATION OF FTB AND BOE--INFORMATIONAL

The Subcommittee Chair, with bipartisan co-authors, has introduced ACA 22 to submit a constitutional amendment to the voters to consolidate the state's two major tax agencies into one entity—the California Tax Board.

BACKGROUND

California has two major tax agencies—the State Board of Equalization (BOE) and the Franchise Tax Board (FTB).

BOE. The BOE is a constitutionally created agency consisting of four members who are elected from districts and the State Controller. The BOE has the following major roles:

- **Property Tax.** Historically, BOE role was to ensure consistent assessment practices between counties, so that property was assessed on a uniform basis throughout the state. However, that role was considerably reduced by Proposition 13, which eliminated most market-value property assessment by county assessors. The BOE still oversees county assessment practices, however. The Constitution also assigns BOE the task of directly assessing certain properties. These "state-assessed" properties include property owned by regulated utilities, pipelines and railroads. The assessment limits of Proposition 13 do not apply to state-assessed property.
- **Sales Tax.** The Legislature has given the BOE the task of collecting and administering state and local sales and use taxes. Most of the board's staff and resources are now in the sales tax program.

- **Excise and Other Taxes.** The board collects the gasoline and diesel taxes, cigarette and alcohol taxes, the electricity surcharge, and a number of other special taxes.
- **Appeals.** The BOE board acts as an appellate body from decisions of the FTB (in addition to hearing appeals of its own staff determinations).

FTB. The FTB consists of three members—the Controller, the Chair of the BOE, and the Director of Finance. The FTB is a statutory entity created by the Legislature to administer income taxes (the Personal Income Tax and the Corporation Tax). More recently FTB also has been given the task of assisting in various collection efforts, particularly child support collections.

Funding and Staffing. The FTB's proposed budget for 2004-05 is \$561 million (\$442 million General Fund), and its proposed staffing is 5,075 personnel-years. The BOE's proposed 2004-05 budget totals \$327 million (\$194 General Fund), and its proposed staffing is 3,462 personnel-years.

COMMENTS:

Consolidating the two tax agencies could result in savings, better coordination, and possibly additional revenue from more effective sharing of information.

The FTB and BOE should comment on the following issues:

- What are the opportunities for efficiencies and savings by consolidating the two boards?
- Would consolidation improve tax administration, both from the state's point of view and from the perspective of taxpayers?
- Would consolidation facilitate information sharing and improve revenue collections?
- What challenges would consolidation pose—either practical or policy?

ITEM 1730 FRANCHISE TAX BOARD

FTB is one of the state's two major tax collection agencies. The FTB's primary responsibility is to administer California's personal income tax (PIT) and corporation tax (CT). Together, these taxes provide more than 60 percent of the GF major tax revenues. The FTB also administers the Homeowners' and Renters' Assistance Program, the Political Reform Act audit program, and the Household and Dependent Care Expense Credit. In addition, the FTB administers several non-tax-related programs, including the collection of child-support payments and other court-ordered payments. A three-member board governs the FTB, consisting of the Director of Finance, the Chair of the Board of Equalization, and the State Controller. An executive officer, appointed by the board, administers the daily operations and functions of the FTB.

The Governor's budget proposes \$560 million (\$442 million GF) and 5,890 positions in support of FTB operations. Compared with the current-year budget, proposed total spending increases by \$28 million (5.3 percent) and GF spending increases by \$9 million (2.1 percent). Proposed staffing declines by 140 PYs - 2.7 percent—to 5,075 PYs. The bulk of the staffing reduction is in the tax administration programs and primarily reflects an increase in the budgeted salary savings requirement, rather than an elimination of specific positions.

The proposed funding increase is due almost to an increase in support for the California Child Support Automation System (CCSAS). This program is funded largely through reimbursements from the Department of Child Support Services (DCSS) but also receives \$47.3 million of GF support within the FTB budget (an increase of \$10.8 million from 2003-04).

Note: Issues resulting from the Assembly Budget Oversight Meetings will be discussed at a subsequent hearing.

ISSUE 1: FEES FOR FTB SERVICES

The LAO recommends adoption of legislation to allow the FTB to impose fees for certain special tax services currently provided free of charge to taxpayers and tax practitioners for a GF savings of roughly \$3.9 million in the budget year.

BACKGROUND

In previous years, LAO has recommended that the FTB begin charging tax practitioners for their use of the tax practitioner hotline. This service provides a high level of technical tax expertise to professional tax practitioners. The FTB has raised concerns that a fee for this service would result in merely rechanneling tax practitioner inquiries to either the toll-free line used by all taxpayers or to district offices. LAO believes that fees for professional tax information are justifiable and appropriate and that they also could be applied to the following additional services:

- **Installment Agreements.** These are agreements that allow certain taxpayers to schedule periodic partial payments on a balance due of under \$10,000 that can be fully paid within 36 months.
- **Refund Stop Payment.** The purpose of this processing activity is to prevent a refund warrant to be cashed by an unauthorized individual.
- **Transcript Preparation or Tax Computation.** These activities require the preparation of a document or report showing annual activity on a taxpayer's account, including: filings, tax amounts, penalty amounts, interest amounts, payments, assessments, credits, and refunds.
- **Lien Release or Subordination.** This service requires the review and analysis of extensive documentation in order to determine whether the removal or subordination of a state tax lien from a specific piece of property is appropriate, prudent, and justified.
- **Rush Services.** These services provide 24-hour "turn-around" for various actions including corporation reviver (brings a corporation out of suspension), escrow demand (used to process lien releases), entity exemption (for tax-exempt corporation status), and estate income tax certificate (certification of taxes paid).

The estimated fee revenue associated with these proposals is shown in the table below:

Franchise Tax Board - LAO Recommended Fees			
Type of Service	Projected Volume	Proposed Fee	Projected Revenue
Installment agreements	117,600	\$15	\$1,764,000
Tax practitioner hotline	200,000	^a	750,000
Refund stop payment	52,345	10	523,450
Tax computation and transcript	47,292	10	516,420
Rush services	20,980	10-75	257,500
Lien release and subordination	500	145	72,500
Total Estimated Revenue			\$3,883,870
^a Probably an annual fee sufficient to cover costs.			

COMMENTS:

- The FTB argues that charging for use of the practitioner hotline will divert calls to the regular taxpayer toll-free line, and that increased compliance problems will result. LAO argues that information available on the regular toll-free line is too general for most practitioner inquiries. FTB also cites a need for additional staff to process fees if the proposal is adopted.
- The California Society of Enrolled Agents (CSEA) argues that the IRS does *not* charge for its equivalent of the practitioner hotline. CSEA agrees with FTB's contention that the hotline saves FTB money by resolving tax issues quickly. Furthermore, CSEA also suggests that a better way to reduce costs is for FTB to expand its on-line help functions.

ISSUE 2: REVENUE ACCELERATION PROGRAM (RAP)

The LAO recommends that the FTB report on the success of the RAP and the potential benefits of extending it.

BACKGROUND

FTB's collections staff budget was augmented by \$3.7 million in 2002-03 on a limited-term basis for the purpose of accelerating the payment of delinquent tax accounts through the RAP. The RAP was established through budget trailer legislation that allowed FTB (and BOE) to waive the

payment of penalties and interest for taxpayers owing balances, in exchange for their immediate payment of unpaid taxes.

The FTB established the eligibility criteria for participation in the program and for contacting potential participants. The program was targeted at taxpayers that had not responded to notices, liens, levies, and telephone or personal contacts for at least two years. Without the RAP program, such accounts would largely be considered noncollectable; no accounts that were deemed to be collectable through other channels were included in the program. The yearlong RAP—running from October 2002 through October 2003—resulted in additional tax revenues of \$32 million. The 35 RAP collection positions expired on December 31, 2003. The program brought in \$36.8 million.

COMMENTS:

- **FTB Indicates Extending the RAP Will Be Cost Effective.** The FTB estimates that extending the RAP one more year would produce \$23 million of additional GF revenue at a cost of \$2 million, for a net benefit of \$21 million. This would require Budget Trailer legislation. Alternatively, the FTB could extend the program by redirecting staff, but the net gain would be reduced to \$11 million due to the loss of other revenue from existing workload. . Extending the RAP requires Budget Trailer legislation.

ISSUE 3: DISTRICT OFFICES

LAO recommends that FTB report on district office restructuring proposals at budget hearings including the phasing in of such changes, budget savings, and revenue impact.

BACKGROUND

The FTB operates 16 field offices throughout the state—Bakersfield, Fresno, Long Beach, Los Angeles, Oakland, Sacramento, San Bernardino, San Diego, San Francisco, San Jose, Santa Ana, Santa Rosa, Stockton, Van Nuys, Ventura, and West Covina—nine of which are located in privately owned buildings and the remainder of which are located in state-owned facilities.

Taxpayer assistance is currently available through four channels: (1) a centralized call center with automated and staffed responses, (2) written correspondence through the FTB central office, (3) walk-in service at 6 of the 16 FTB field offices, and (4) Internet access through the department's Web site. The FTB's call center handles approximately 3 million inquiries per year. In addition, electronic services (Internet and interactive voice response) receive over 25 million taxpayer contacts. However, these forms of assistance do not provide customized services to taxpayers. Direct taxpayer contacts through public access counters typically have ranged from 200,000 to 250,000 annually.

The FTB estimates that a call center response to a taxpayer inquiry cost an average of \$6.07 in 2000-01, compared to \$5.21 for a written response, and \$11.15 for a field office contact. The

FTB estimates that roughly 75 - 80 percent of inquiries received through the public access counters could be addressed though the Internet or the call center.

Public Counters Remain at Six Field Offices. The FTB recently closed public access counters at all district offices except for Oakland, Los Angeles, Sacramento, San Diego, Santa Ana, and San Francisco. The department estimates that this will achieve personnel and lease savings of somewhat less than \$1 million. After closure, approximately 75 percent of taxpayers are within a 50-mile radius of a public access counter (versus about 95 percent formerly).

LAO Suggests More Consolidation. LAO believes that auditing and collection activities now conducted through some field offices could be effectively carried out through alternative means at a substantially lower cost. Such alternative administrative venues include telephone communication, shifts to other district offices, or the transfer of activity to the Sacramento main office.

COMMENTS:

FTB Response - Long-Term Savings, But Up-Front Costs. The FTB indicates that it could achieve further savings by closing the ten field offices that no longer have public counters. Staff would be relocated. However, there would be an initial cost of \$841,000 in 2004-05 for moving expenses and lease obligations. Net savings would be achieved starting in 2007-08. From then, ongoing annual savings would be \$637,000.

ISSUE 4: SHOULD THE CHILD SUPPORT AUTOMATION SYSTEM BE TRANSFERRED?

LAO recommends that the Legislature direct FTB and DCSS to analyze the possibility of transferring the California Child Support Automation System (CCSAS) and report at budget hearings on potential problems or project disruptions that could occur as a result of such a transfer, and that DCSS analyze the CCSAS workload and report at budget hearings on the potential savings that could be achieved as a result of the transfer.

BACKGROUND

Federal law requires states to have completed the development and implementation of statewide child support systems by 1997. Since California did not complete its system by that time, the federal government reduces, in the form of penalties, its share of the costs for administering the state's child support program. Through the budget year, federal penalties will have totaled almost \$1 billion. When CCSAS is fully implemented in 2008, the federal penalties should be eliminated.

State Law Requires Franchise Tax Board (FTB) to Manage Project. Chapter 479, Statutes of 1999 (AB 150, Aroner) requires the FTB to act as the agent for DCSS to procure, develop, implement, and maintain the new statewide system. In 1999, the Legislature required FTB to manage the project because (1) FTB had experience procuring and managing large information technology (IT) projects and (2) DCSS would be focusing on implementing the state's newly

reformed child support program. The FTB and DCSS staff assigned to CCSAS work together in the same DCSS office building.

LAO points out that transferring CCSAS to the direct control of DCSS could have the following benefits:

- Increase DCSS Accountability.
- Reduce Project Staff.
- Eliminate Coordination Activities.
- Allow FTB to Focus on Revenue Collections.

LAO stipulates, however, that the CCSAS project is the state's largest and most complex state IT project, and consequently there would be some risk in transferring the system. LAO believes some of this risk would be minimized if the same project staff and best practices were transferred with the project.

COMMENTS:

- The FTB should report to the subcommittee on the potential risks and benefits of transferring the CCSAS system to DCSS.
- FTB also should report to the subcommittee on the current status of the project, the eventual cost and schedule for implementation, and whether current plans would keep the system at FTB permanently or transfer the operation to DCSS after it is well established.

ISSUE 5: FEE FUNDING FOR POLITICAL REFORM AUDITS

The budget proposes a GF savings of \$1.4 million in 2004-05 by replacing GF support for Political Reform audits with fee funding. Under the Political Reform Act of 1974, FTB conducts compliance audits of randomly chosen candidates and other political entities. The new fees would be levied on candidates, lobbyists, lobbying firms, lobbyist employers, and certain political committees. The new fee requirement would be imposed by Trailer Bill language.

COMMENTS:

- The Legislature rejected a similar proposal last year because it proved unwieldy and unworkable. Applying the fee requirement to local candidates would impose a state mandate on localities for administration and collection.
- Applying the fee only to statewide entities subject to the Secretary of State's electronic filing requirement would necessitate an annual fee of \$900 to achieve the full amount of budgeted savings.
- Funding for FTB's audits is appropriated in the Political Reform Act item (8640).

ISSUE 6: OTHER PROPOSALS

The Governor's Budget includes the following additional proposals:

- PIT Nonfiler Program. Augmentation of \$1.8 million and 28.1 PYs to address manual review workload generated by the automated system that identifies potential nonfilers. The estimated annual GF revenue gain is \$63 million, beginning in 2007-08.
- California Missions Foundation. \$6,000 to implement SB 92 (Speier) for a tax checkoff program.
- Voter Registration Card. \$236,000 to implement SB 448 (Poochigian) requiring FTB to include voter registration cards in annual mailings of tax forms.

ISSUE 7: APRIL FINANCE LETTERS

The Department of Finance has submitted requests for approval of the following budget augmentations:

1. **Real Estate Withholding**--\$575,000 to continue 10.9 PYs of a total of 31 PYs that expire at the end of 2003-04. The FTB estimates that the program will result in revenue collections of \$157 million in 2004-05.
2. **Central Processing Unit Capacity and Memory**--\$1 million to provide necessary tax return processing capacity.
3. **Phase III Building Occupancy**--\$6.5 million (\$6 million GF), primarily for the Department of General Services Building and Property Management Branch and additional utility costs for approximately 1 million square feet of new space that is opening with completion of Phase III of the Butterfield Campus.

Note: An additional Finance letter request for \$400,000 to enhance resources to combat abusive tax shelters will be considered at a subsequent hearing in connection with the recommendations from the Budget Oversight Meetings.

ITEM 8885 COMMISSION ON STATE MANDATES

The Commission on State Mandates determines whether local government claims for reimbursement of state-mandated local costs should be paid by the state. If the commission determines that a statute, executive order, or regulation contains a reimbursable mandate, the commission develops an estimate of the statewide cost of the mandated program and includes this estimate in a semiannual report. After receipt of this report, state law specifies that the

Legislature appropriate funding in a "claims" bill to pay the newly approved mandates. Subsequent-year costs of the mandate are then funded through the budget, under each affected department.

The budget proposes \$1.2 million from the GF for support of the commission in 2004-05. This is a reduction of \$69,000 from estimated spending in the current year. Staffing declines from 10.2 PYs in 2003-04 to 9.7 PYs in 2004-05.

Administration's Mandate Proposal. Consistent with the Legislature's intent as expressed in Chapter 228, Statutes of 2003 (AB 1756, Committee on Budget), the administration's budget plan includes no funding for mandate reimbursements. Instead, all 2004-05 mandate costs (approximately \$600 million) and all unpaid mandate claims from 2003-04 and earlier (over \$2 billion) will be deferred to an unknown future date.

Special Committee on State Mandates. The Speaker appointed the Special Committee in 2003 to take an in-depth look at individual state-mandated local programs, the mandate process, and potential policy changes regarding mandates.

ISSUE 1: MANDATE RECONSIDERATION WORKLOAD

AB 2851 (Laird) will implement a number of the Special Committee's recommendations. Included in AB 2851 (currently in the Assembly Appropriations Committee), is a requirement for the commission to reconsider the following specific mandates in light of federal statutes enacted, and federal and state court decisions rendered since the enactment of the statute that imposed the mandate:

- a) Sex offender disclosure by law enforcement officers
- b) Extended Commitments in the California Youth Authority
- c) Brown Act Reforms
- d) Photographic Record of Evidence

COMMENTS:

The commission should report to the subcommittee regarding whether its budget provides adequate funding to accomplish the mandate reviews required by AB 2851.

ISSUE 2: APRIL FINANCE LETTER REQUEST

The Department of Finance requests addition of an item to the budget to transfer the remaining fund balance of \$461,000 from the State Mandates Claims Fund to the GF. The purpose of the State Mandates Claims Fund was to pay small initial mandate claims. However, it has not been used in recent years

Given the large amount of outstanding unpaid mandate claims, the amount remaining in the fund would not make a meaningful contribution. Transferring the remaining balance to the GF is consistent with the Legislature's decision to defer mandate payments.

ISSUE 3: MANDATE REFORM

In the *Perspectives and Issues* volume that accompanies the *2004-05 Analysis*, the LAO provides a detailed review of the current status of mandate payment deferrals, describes the current mandate claiming process, and identifies the following six areas of concern that merit legislative consideration in a reform proposal:

- Lack of payments undermines credibility of mandate requirement.
- Little confidence in mandate determination process.
- Claiming system invites problems.
- Legislature needs better information.
- Delays decrease legislative oversight.
- Mandate determinations are stuck in the past.

Elements of Mandate Reform

The administration has outlined several concepts for modifying shortcomings within the mandate system. For example, the administration proposes establishing a requirement that local agencies use the "least costly approach" when complying with state requirements. The LAO believes that deeper reforms are needed. The LAO proposes the following key elements of mandate reform:

- The Legislature should have access to mandate cost and other information during the legislative process. State agencies also should have assistance during the development of regulations.
- The body charged with making mandate determinations should be reconstituted so that all parties view it as objective.
- State agencies should actively participate in the mandate determination process, ensuring that state views and interests are documented and presented.
- Local governments should have some recourse to reduce their fiscal liabilities if the state does not fund mandates.
- The mandate determination process should be timely, with the Legislature learning of new mandates and their costs before or shortly after the mandate is established.
- The mandate claiming process should be simple, credible, timely, and easy to audit. Whenever possible, claims should reflect unit cost methodologies rather than open ended claiming.
- Mandate determination and claiming procedures should be updated as needed to reflect modern conditions, laws, and court rulings.

ITEM 9650 HEALTH & DENTAL BENEFITS FOR ANNUITANTS

The state contributes toward health and dental insurance premiums for annuitants of the Judges', Legislators', District Agricultural Employees', and Public Employees' Retirement Systems, as well as specified annuitants of the State Teachers' Retirement System. Annuitants have the option of selecting from up to eight state-approved health plans depending on where an annuitant lives. The state's contribution for individuals is the average premium for the four most popular plans. For couples and families, the state also contributes 90 percent of the additional cost over the single premium contribution (based on the average of the four plans).

Health and Dental Benefits for Annuitants					
(Dollars in Millions)					
Program	2002-03	2003-04	2004-05	Change From 2003-04	
	Actual	Estimated	Budgeted	Amount	Percent
Health	\$511.9	\$647.7	\$796.7	\$149.0	23.0%
Dental	49.0	54.9	59.4	4.5	8.2
Totals	\$560.9	\$702.6	\$856.1	\$153.5	22.0%

The budget proposes total expenditures of \$856 million from the GF for health and dental benefits for annuitants in 2004-05. This is \$153 million, or 22 percent, more than estimated expenditures for this purpose in the current year. This increase mainly reflects 2004 health insurance premium increases of 18 percent for basic managed care plans and almost 27 percent for Medicare managed care plans, on average. It also assumes similar changes in health insurance premiums that would go into effect January 1, 2005. Although these costs are initially paid from the GF, the state recovers a portion of these costs (about 33 percent) from special funds through pro rata charges.

ISSUE 1: ESTIMATE WILL BE UPDATED IN MAY REVISION

The actual amount needed in the budget year is dependent on negotiations over health insurance premiums currently underway between the Public Employees' Retirement System and providers. These negotiated premium rates, which will cover the 2005 calendar year, will be reflected in the May Revision.

ITEM 9840 AUGMENTATION FOR CONTINGENCIES OR EMERGENCIES**BACKGROUND**

Control Section 27.00 of the Budget Bill authorizes the Director of Finance to approve deficiency or emergency spending requests, subject to legislative notification. Deficiency spending is limited to "cases of actual necessity" for unanticipated expenses for the operation of existing programs. Emergency spending is limited to conditions of disaster or extreme peril. These special spending authorizations allow departments to spend at a rate which would result in a deficiency – that is, the additional spending would exhaust their existing appropriations before the end of the fiscal year.

The Budget Act annually provides nominal appropriations for unforeseen contingencies or emergencies. The Budget Bill includes \$2 million GF and \$3 million from special funds for these items in 2004-05. The Department of Finance allocates amounts as required. Because the amounts provided in the Budget Act are nominal, the Department of Finance annually sponsors a deficiency bill to provide the additional funding needed to backfill deficiency spending. The Budget Bill also includes \$2.5 million GF loan authority to meet the needs of programs which would be curtailed due to delayed receipt of reimbursements, revenues or other financing.

No spending amount is shown in this item for 2002-03 because all deficiency spending for the past year has been allocated to the individual departments and programs that incurred the deficiencies.

ISSUE 1: RETHINKING THE DEFICIENCY PROCESS

In an extensive review of the deficiency process in the *Perspectives and Issues* volume, the LAO observes that the deficiency process has not worked well as a true emergency spending mechanism or in limiting spending to purposes that are consistent with legislative intent.

LAO suggests substantial changes in the deficiency process. These include deletion of Section 27.00. Instead unforeseen funding needs would need to be funded through new appropriations while the Legislature is in session. Alternatively, while the Legislature is out of session, unanticipated needs would be funded directly from this item (9840), which would need a larger appropriation.

COMMENTS

- The Department of Finance should update the subcommittee on the current amount of approved deficiencies and any pending or anticipated deficiencies.
- LAO should review their deficiency reform proposal and explain its impact on this budget item.