AGENDA
ASSEMBLY BUDGET SUBCOMMITTEE NO. 4
ON STATE ADMINISTRATION

Assemblymember Warren Furutani, Chair

WEDNESDAY, APRIL 21, 1:30 PM
STATE CAPITOL, ROOM 437

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CONSENT ITEMS

ITEM 0950 STATE TREASURER’S OFFICE

ISSUE 1: APRIL FINANCE LETTER – BOND REDEMPTION TRAILER BILL LANGUAGE

The Treasurer’s Office has requested Trailer Bill Language that would allow them to redeem matured bonds and coupons that are 10 years or more past their call date when presented for payment by the bondholder. Currently, for matured bond and coupons retrieved past their call date, claims must be paid through the Victims Compensation and Government Claims Board (VCGCB). The Board is authorized to assess a 15% surcharge on those matured bonds and coupons that are redeemed through their existing process. The Board has recently begun charging that fee on the Treasurer’s Office. This language would allow them to avoid that fee.

ISSUE 2: FEDERAL CHARTER SCHOOL FACILITIES INCENTIVE GRANTS PROGRAM

The Treasurer’s office requests federal expenditure authority to administer $46.1 million in federal funds received through the Federal Charter School Facilities Incentive Grants Program. This program allows the Treasurer's office to use up to 5% of the award toward administrative costs. These funds will be administered over the next 5 years.

ITEM 8380 DEPARTMENT OF PERSONNEL ADMINISTRATION

ISSUE 1: 21ST CENTURY PROJECT

This April 1 Finance Letter proposes to increase Reimbursement Authority for the Department of Personnel Administration by $278,000. This increase conforms to changes made for the 21st Century Project in the State Controller’s budget. The 21st Century Project is a collaborative, statewide effort to replace and improve payroll processes and systems.
ITEM 8830  CALIFORNIA LAW REVIEW COMMISSION

ISSUE 1: FUNDING SHIFT

The Governor's budget proposes to shift General Fund support of $666,000 for the Law Review Commission to reimbursement from the Legislature's budget.

Staff proposes the adoption of the following budget bill provision that pays these reimbursements for the Law Review Commission from the Legislative Counsel Bureau's budget:

For the 2010-11 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.

ITEM 8840  COMMISSION ON UNIFORM STATE LAWS

ISSUE 1: FUNDING SHIFT

The Governor's budget proposes to shift General Fund support of $148,000 for the Commission on Uniform State Laws to reimbursement from the Legislature's budget.

Staff proposes the adoption of the following budget bill provision that pays these reimbursements for the Commission on Uniform State Laws from the Legislative Counsel Bureau's budget:

For the 2010-11 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.
ITEMS TO BE HEARD

2100 ALCOHOLIC BEVERAGE CONTROL

The Department of Alcoholic Beverage Control is vested with the exclusive power to license and regulate persons and businesses engaged in the manufacture, importation, distribution and sale of alcoholic beverages in the State of California. The Department's mission is to administer the provisions of the Alcoholic Beverage Control Act in a manner that fosters and protects the health, safety, welfare, and economic well being of the people of California.

Following are expenditures and positions (dollars in thousands):

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<thead>
<tr>
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<th>2008-09 (actual)</th>
<th>2009-10 (estimated)</th>
<th>2010-11 (proposed)</th>
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<td>Personnel Years</td>
<td>420.0</td>
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ISSUE 1: LIQUOR LICENSE FEE ADJUSTMENT

The Governor's budget proposes to raise the fee for a general license by 15%, from $12,000 to $13,800. The proposed fee adjustment is projected to generate increased revenue of $788,400.

BACKGROUND

Section 23954.5(b) of the Business and Professions Code establishes a $12,000 original fee for a general license (beer, wine, and distilled spirits). The Department of Alcoholic Beverage Control (ABC) is authorized to issue licenses each year based upon county population increases.

The ABC is statutorily required to adjust its annual renewal fee by the Consumer Price Index (CPI). However, the original general license fee of $12,000 has not been adjusted since 1995. If the general license fee were adjusted annually for the CPI since 1995, it would have been approximately $17,700 in 2008.

A general license fee can be sold on the open market. The current market value for an off-sale general license in California is estimated between $30,000 and $50,000. The current market value for an on-sale license in California is estimated between $60,000 and $70,000. In metropolitan areas such as Los Angeles and San Francisco, a general license fee can be valued at up to $100,000.

The ABC Fund is facing a structural deficit. Even with this fee increase and another revenue proposal (Issue 3), the fund is projected to expend approximately $2.9 million more than revenues in $2010-11.

COMMENTS

The ABC Fund will not be able to sustain current expenditures levels without an increase in revenues. If reduced expenditures were required, the ABC reports that its local assistance grants for local law enforcement and Licensed Education on Alcohol and Drugs program would be the most likely affected.
ISSUE 2: IT INFRASTRUCTURE REPLACEMENT

The Governor's budget proposes $86,000 from the Alcohol Beverage Control Fund to replace computer workstations and laptops per the ABC’s refresh policy.

BACKGROUND

In 2003-04, the ABC implemented Windows workstations for all permanent employees. The project did not include funding for equipment refresh and, on an annual basis, the ABC has been submitting Budget Change Proposals (BCP) for funding to replace those systems approaching the refresh goal of five years.

A BCP was approved in 2009-10 that will allow the ABC to replace up to one hundred forty-five desktops and one hundred thirty-eight laptops. For 2010-11, the ABC still reports a need to replace seventeen desktops and forty-four laptops, which were manufactured by a bankrupt corporation (MPC/Gateway) and, therefore, no longer have valid warranties.

ABC reports that its computing needs have increased in recent year. Investigators and licensing representatives now regularly use photographs in reports; analyze video taken from crime scene; and import surveillance audios into computers.

COMMENTS

This proposal would complete the ABC’s current replacement cycle.
ISSUE 3: CATERING/EVENT AUTHORIZATION FEE ADJUSTMENT

The Governor's budget proposes to increase the Catering and Event Authorization fees from $10 to $25. Upon full implementation, the fee increases would generate an estimated $256,500 in new revenues to be deposited into the Alcoholic Beverages Control Fund.

BACKGROUND

The Department’s fees for the review, processing, and issuance of catering and event authorizations is currently $10. The fee for catering authorization has not been adjusted since its statutory imposition in 1979, and the fee for an event authorization has not been adjusted since 1997.

The ABC Fund is facing a structural deficit. Even with this fee increase and the previously discussed revenue proposal (Issue 1), the fund is projected to expend approximately $2.9 million more than revenues in 2010-11.

COMMENTS

The administrative costs of reviewing, processing, and issuing these authorizations ($35-$45) significantly exceed the current fee allowed. This increase would bring the fee closer to actual administrative costs.
8550 HORSE RACING BOARD

The California Horse Racing Board regulates pari-mutuel wagering for the protection of the betting public and promotes the horse racing and breeding industries.

Jurisdiction and supervision over meetings in California where horse races with wagering on their results are held, and over all things having to do with the operation of such meetings, are vested in the seven-member California Horse Racing Board, who are appointed by the Governor. Principal activities of the Board include:

- Protecting the betting public;
- Licensing of racing associations and participants in the racing industry;
- Allocating the racing days and charity days conducted by racing associations;
- Enforcing laws, rules, and regulations pertaining to horse racing in California;
- Acting as a quasi-judicial body in matters pertaining to horse racing meets;
- Encouraging agriculture and the breeding of horses in the state; and,
- Collecting the State's lawful share of revenue derived from horse racing meets.

The following are expenditures and positions (dollars in thousands):

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<thead>
<tr>
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<th>2009-10 (estimated)</th>
<th>2010-11 (proposed)</th>
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<tr>
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<td>$11,734</td>
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<tr>
<td>Personnel Years</td>
<td>55.2</td>
<td>57.9</td>
<td>59.7</td>
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ISSUE 1: AUDIT POSITIONS

The Governor's Budget proposes $148,000 from the Horse Racing Fund and two positions to address audit workload, primarily driven by recently enacted legislation.

BACKGROUND

2009 legislation, SB 766 (Negrete McLeod) and SB 517 (Florez), provide more flexibility for the horse racing industry related to the “take out” (the share of dollars bet used for purposes other than to pay winning bets). Both bills further require that the changes authorized must be approved by the California Horse Racing Board (CHRB). Specifically, SB 766 permits uncommitted surplus funds in specified accounts to be reallocated to other funds or accounts and SB 517 authorizes changes in the amount and distribution of the "take out" at races upon a filing with and approval by the CHRB.
The additional positions would be funded from the Horse Racing Fund, which was established in the 2009-10 Budget Act. The enabling Trailer Bill Language also changed the collection of revenues for support of the Board in the new fund. The Governor's budget projects a fund balance of $2.6 million at the end of the budget year based on projected revenues of about $12.8 million in both the current year and budget year. Even with the proposed increased staffing levels under this proposal, the fund is projected to take in about $1 million more than it would expend in the budget year.

COMMENTS

Even though it is not clear exactly how much new workload will be driven by SB 766 and SB 517, there will be a workload increase. The CHRB does not have enough audit staff to support current departmental audit workload. CHRB currently has two audit staff and a current year audit work plan that requires just fewer than 3.5 staff.
ITEM 2180 DEPARTMENT OF CORPORATIONS

The Department of Corporations, under the direction of the California Corporations Commissioner, provides consumer and investor protections by regulating the conduct of a variety of businesses, including securities brokers and dealers, investment advisers and financial planners, and certain fiduciaries and lenders. The Department also oversees the offer and sale of securities, franchises and off-exchange commodities.

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<th>2009-10 (estimated)</th>
<th>2010-11 (proposed)</th>
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<td>Expenditures</td>
<td>$34.5 million</td>
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<tr>
<td>Personnel Years</td>
<td>286.3</td>
<td>316</td>
<td>330.2</td>
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The increased costs from 2009-10 to 2010-11 are attributed to the end of furloughs ($2.8 million), continuation of an IT project previously approved in prior years ($3.1 million), and BCP’s being heard by the sub-committee ($1.5 million).

ISSUE 1: IT WORKLOAD

The Department requests two positions and $300,000 to address the increase in workload resulting from 82 new positions over the past 6 years, during which time the IT staff has remained the same. This revenue is produced through fees charged on those entities served by the Department, and will not result in a fee increase.

Staff raises no concerns with this proposal.

ISSUE 2: APRIL FINANCE LETTER – FUND SWEEP

The Department of Corporations recently received a lump sum of penalty payments (from a court ruling) increasing the Departments reserves. Because penalty revenue is fungible, the Governor’s Office has proposed sweeping $20 million of those funds to the General Fund. This action still allows the Department to maintain a prudent reserve.

Staff raises no concerns with this proposal.
ITEM 2150 DEPARTMENT OF FINANCIAL INSTITUTIONS

The mission of the California Department of Financial Institutions is to promote the integrity and stability of California's financial services system through the regulation and supervision of financial institutions that are either required to be licensed by the state or that choose a state license.

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<tr>
<td>Expenditures</td>
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<tr>
<td>Personnel Years</td>
<td>246.7</td>
<td>253.5</td>
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ISSUE 1: MONEY TRANSMITTERS

The Department requests $1 million and 8.6 PY's to maintain enforcement and review activities over money transmitters. These positions were established on a limited term basis in the 2008-09 budget. Since then, the Department has seen a continued increase in the use of money transmitters, and an increase in the number of poorly rated licensees, necessitating additional monitoring and enforcement. This action would make these positions permanent.

Staff raises no concerns with this proposal.

ISSUE 2: APRIL FINANCE LETTER

The Department requests $1 million and 10 positions to increase the supervision within the Banking and Credit Union programs.

The Department anticipates the chartering of a new $19 billion bank that will increase considerably the workload for the Department. This addition, combined with the deteriorating conditions within the financial industry, led to the Department's request for 7 of the 10 positions (2 specific to the workload for the new bank, 5 to handle the increased pressure from the fiscal downturn).

The final 3 positions requested are intended to assist in the regulation and monitoring of credit unions, which are also feeling the impact of the financial downturn.

The Department claims it is attempting to implement a proactive regulatory approach to deal with the current financial market conditions. They have implemented a “risk-based examination schedule,” expanded the review of loan portfolios to better ascertain the condition of the portfolio, and issued an increasing number of formal and informal enforcement actions.

The Department uses a rating system known as CAMELS (Capitol, Assets, Management, Earnings, Liquidity, Sensitivity) to evaluate the condition of a financial institution based on a scale of 1 to 5, with 1 and 2 considered to be satisfactory, 3 to be an institution of concern, and 4 and 5 considered to be at risk of failure. Since the 3rd quarter of 2008, the number of institutions with a ranking of 3 or below has increased from 73 to 159 (constituting 41% of all
state licensees). Problem institutions require an increased level of supervision, for which the Department is not currently staffed to provide. As evidence of the increased workload, the Department points out that the number of institutions with enforcement actions has increased from 39 to 145 since September of 2008.

COMMENTS

Though the new $19 billion bank has not yet been formally certified for California, the Department assures staff that they have no reason to believe it will not proceed as planned, and be certified prior to July 1, 2010.

The assessment fees that will be paid by the new bank will provide nearly enough revenue ($909,000) to cover the entire cost of this request. The positions are funded out of the Departments special fund, funded by assessments on the entities they serve, and will have no General Fund impact.

The Department requests these positions as permanent positions. They point out that since they made their original budget request, the banking industry has continued to deteriorate. Over 50% of all state licensees are now in the lower three rankings, compared to 41% at the time of their original request. This continued deterioration simply increases their workload, and suggests a longer time-period before a full recovery will occur.

Additionally, the Department plans to modify their operating procedures to help address problems the recent financial crises highlighted in their methods of operation. Staff strongly encourages the Department to continue with their evaluation of their operations, but suggests that it may be beneficial for the Department to return in two years to update the Committee on both the status of the financial world, as well as the outcome of their efforts to address their current operating short-comings.
ITEM 0950  STATE TREASURER’S OFFICE

The State Treasurer, a constitutionally established office, provides banking services for state government with goals to minimize interest and service costs and to maximize yield on investments. The Treasurer is responsible for the custody of all monies and securities belonging to or held in trust by the state; investment of temporarily idle state monies; administration of the sale of state bonds, their redemption and interest payments; and payment of warrants drawn by the State Controller and other state agencies.

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<td>$26.7 million</td>
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<td>Personnel Years</td>
<td>222.5</td>
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ISSUE 1: CASH MANAGEMENT DIVISION

The Treasurer's office requests 1 position and $103,000 (reimbursements) to handle the workload for the Bank Reconciliation Section. This position was established as a two year limited term. Workload has continued to increase since then, so this request would permanently establish the position.

Staff raises no concerns with this proposal.

ISSUE 2: CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE

The Committee requests $250,000 in federal expenditure authority to contract with CalHFA to complete the processing of $1.1 billion in loans administered pursuant to the ARRA during the 09/10 fiscal year.

This is consistent with prior year actions by this sub-committee.
ISSUE 3: APRIL FINANCE LETTER – LOCAL AREA INVESTMENT FUND TRAILER BILL LANGUAGE

The State Treasurer’s office requests Trailer Bill Language to adjust the limitations on administrative cost recovery for the Local Agency Investment Fund (LAIF).

The LAIF is a voluntary program created in 1977 as an investment alternative for California’s local governments and special districts. The LAIF program offers local agencies the opportunity to invest idle funds and earn a competitive yield using the investment expertise of the Treasurer’s investment staff at no additional cost to the taxpayer. LAIF has nearly 3,000 participants and nearly $25 billion in investments.

Existing law allows the Treasurer’s office to deduct up to one half of one percent of the LAIF earnings to cover reasonable costs it has incurred in carrying out the provisions of the program. This has historically left enough of a buffer for the Treasurer’s office to fully cover the costs of administering the program, approximately $400,000. Recently, however, because of the decline in the market, this cap has become problematic. The cost to administer the program remains at approximately $400,000, but because investment returns have dramatically decreased, one half of one percent no longer equates to more than $400,000. As such the Treasurer’s office is not able to cover the costs of administration.

COMMENTS

This proposal would raise that cap to 5%, but adds language to limit these costs to those appropriated in the budget act. Additionally, reimbursement of administrative costs is already limited in current law to “the reasonable costs incurred in carrying out the provisions” to operate LAIF.

LAIF has added only 1 staff position in the past 10 years, despite doubling their investment amounts, and has managed the program effectively. This request is due to the drastic changes in market conditions.

Staff raises no concerns with this proposal.
ITEM CONTROL SECTION 15.45

ISSUE 1: ALLOCATION OF REDEVELOPMENT AGENCY FUNDS

The Governor's budget proposes to add Control Section 15.45 to create a mechanism for the State Controller's Office to offset General Fund expenditures with $350 million in tax increment revenues that will be received from Redevelopment Agencies pursuant to budget actions last year. This exact language was included in last year's budget, but was inadvertently left out of this year's budget proposal.

COMMENTS

This Control Section implements the technical mechanism necessary to enable the state to achieve the intended savings of $350 million, pursuant to last year's budget actions.
ITEM 0840 STATE CONTROLLER’S OFFICE

The State Controller is the Chief Fiscal Officer of California. The Controller provides sound 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.

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<tr>
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<tr>
<td>Personnel Years</td>
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<td>1,392.9</td>
<td>1,405.2</td>
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The increase in funding is primarily driven by the request (issue 5 below) regarding the 21st Century Project.

ISSUE 1: MANDATE AUDITS WORKLOAD

The Governor's Budget requests $1 million (General Fund) and 10 positions to perform mandated audits that the Controller's Office estimates will annually generate $29 million in revenue. The Mandated Audits Bureau is primarily responsible for conducting audits of claims submitted by cities, counties, community colleges, and school districts.

If the State enacts a statute or imposes an executive order that results in increased costs for local agencies or school districts but does not provide the funding to cover these costs, the affected local agencies and school districts may seek reimbursement from the State. In order to determine whether submitted reimbursement claims are for increased costs incurred as a result of the State mandate, the State Controller's office performs compliance audits of local agencies and school districts in accordance with the existing law. The compliance audits also determine whether costs claimed were supported by appropriate source documents, funded by another source, or are unreasonable and/or excessive. Over the past 10 years, the Controller audited nearly 1,500 claims, and had $525 million in audit findings. The total claims amount for those claims was $1.1 billion, meaning that the claims were nearly 50% over-stated. Over the history of the audit program, the Controller's office has identified $29 in audit findings for every $1 in staffing costs – which was used to estimate the $29 million in revenue gain from this proposal.

With 33 staff over the past two years, the Controller's office was only able to audit approximately 1.8% of the total number of claims, and 23% of the dollar amount of annual claims. This proposal will increase that to allow auditing of 30% of all dollars claimed.

Staff raises no concerns with this proposal.
ISSUE 2: INCREASED RENT AND POSTAGE

The Governor’s Budget requests $874,000, from various special funds for increased rent and postage expenses. The State Controller was able to absorb some of these costs last year, but cannot continue to do so without eroding services provided. The rent increases are based on CPI and adjustments to the base fees approved in existing contracts. Postage prices continue to increase every year, and funding must be adjusted to keep pace.

Staff raises no concerns with this proposal.

ISSUE 3: REIMBURSABLE PAYMENTS WORKLOAD

The Governor's Budget requests $1.779 million in additional reimbursement authority to address payments workload volume increases and to continue to meet its contractual responsibilities. The Controller's office has the responsibility to ensure proper payments for all state agencies and funds, including retirement rolls for PERS and STRS, and the Department of Social Services (DSS). These entities must reimburse the Controller's Office for the services they receive. This proposal adjusts the Controller's reimbursement authority to account for higher than expected growth trends in retiring populations served by PERS and STRS, as well as the increasing popularity of payroll deductions to pay for items such as car loans, home mortgage payments, etc. The Controller has entered into interagency agreements with all departments for reimbursement of these costs, and this action brings the Controller's Office budget in line with those agreements.

Staff raises no concerns with this proposal.

ISSUE 4: CALIFORNIA CHILD SUPPORT AUTOMATION SYSTEM AUDITS (CCSAS)

The Governor's Budget requests $101,000 in reimbursement authority to allow the Controller to continue to fulfill its responsibilities associated with the CCSAS. In 2009-10, the Controller's office received 1.5 positions (one-year limited-term) and $154,000 in reimbursement authority to support the CCSAS. The Controller has determined that the .5 PY is no longer needed, but that the monitoring activities, ongoing claim schedule and automated/manual post-payment audits will require the other position to be permanently established.

Staff raises no concerns with this proposal.
The Governor's budget requests 111 two-year limited term positions and $66 million ($30 million General Fund) to continue the implementation of the 21st Century Project which will result in an integrated human resource management system to replace the existing payroll, employment history, position management and leave accounting legacy system.

The SCO pays approximately 249,000 employees, including state civil service, California State University and Judicial Council employees, judges, and elected officials. The 21st Century Project (Project) will replace the existing statewide human resource management systems in order to improve management processes and fulfill payroll and reporting obligations accurately and on time. The Project began in May 2004 and is currently projected to end in 2012-13; the current estimated total cost (one-time and continuing) is $307.8 million.

In January 2009, the State terminated the contract with BearingPoint, the Project systems integrator, for failure to meet contractual commitments. There is the potential for recovery of a performance bond from the prior systems integrator, anticipated to offset project costs by $25 million. The Committee may wish to ask if there is any update on the effort to recover those funds.

After contract termination, the SCO developed a “go-forward” strategy to complete implementation of the Project. The major change in this strategy included revising the scope of the Project to exclude CSU employees, which the SCO indicated will be addressed in a separate project at a future time. This revised approach was included in Special Project Report No. 3 which was approved by the Office of the Chief Information Officer (OCIO) in May 2009. The SCO then began the process to procure a new systems integrator to complete the Project. The SCO has since completed the procurement and selected SAP Public Services, Inc., as the new systems integrator. The new contract includes the system integrator services and supplemental software tools necessary for the completion of the Project.

On January 21, 2010, the Joint Legislative Budget Committee (JLBC) approved a Control Section 11.00 request from the SCO related to the Project. This Section 11.00 request was based on the OCIO’s December 16, 2009, approval of Special Project Report No. 4 for the Project which delineated several contract changes and cost adjustments. In its letter approving the SPR, the OCIO specified several conditions for the Project including submission of a detailed cost tracking report on a quarterly basis.

As noted, the JLBC approved the Section 11.00 request. However, due to the magnitude and complexity of the Project, the JLBC requested that the SCO provide the Senate Budget and Fiscal Review Committee and Legislature with regular updates as the Project progresses, including the quarterly cost tracking report that is provided to the OCIO. Additional requested information included updates on the status of the Bearing Point litigation and more information about how the Project is managing risks that could impact the performance of the system or the cost of the Project.
 COMMENTS

The need to transition the state from a transaction-based system to an enterprise database system that supports the business needs of state government is clear. This project continues to be on track, and provide constant updates to the Legislature on their progress. Their first report will be provided in a matter of weeks, and the Controller's Office staff has consistently been very responsive to all requests from the Legislature.

Pursuant to the Joint Legislative Budget Committee request, the Controller's Office will continue to provide quarterly reports on progress to the Legislature, allowing proper oversight of this important project.

ISSUE 6: DISPROPORTIONATE SHARE HOSPITAL PROGRAM

The Governor's Budget requests $1.1 million in reimbursement authority to perform audits for the Department of Health Care Services' Disproportionate Share Hospital Program (DSH). This program assists hospitals that serve a large number of Medicaid/Medical and low-income patients. The state pays the hospital a DSH payment in addition to the standard Medicaid payments. The Federal government requires significant reporting and auditing on the $1.2 billion it provides to California every year. DHCS requested that the Controller's office perform the required audits, and agreed to reimburse them for their full cost of providing those services. This proposal simply provides the Controller with the ability to accept those reimbursements.

 COMMENTS

This request will be fully reimbursed, through DHCS, by the federal government. This item, however, requests ongoing budget authority while DHCS has only agreed to fully fund the cost of the audit program for the first two years. Therefore, staff recommends that the subcommittee approve this budget item but designate the positions as two-year limited-term to allow the Legislature to revisit this issue in two years time when DHCS will also be reviewing the DSH audit program.
ISSUE 7: INCREASED ACCOUNTING AND REPORTING WORKLOAD

The Governor's budget requests $500,000 ($250,000 GF and $250,000 special fund) in ongoing funding to manage the increased workload in the Controller's office Division of Accounting and Reporting related to (A) Reporting, (B) Actuarial Advisory Support, and (c) Cash Management.

A. Financial Reporting.

The Controller's office provides fiscal controls for, and independent oversight of, more than $100 billion in receipts and disbursements of public funds. A major part of these duties include gathering, reviewing, and publishing the annual reports of financial transactions of all local governments in California, as well as the establishment and oversight of uniform accounting policies and procedures for local governments. Local agencies are subject to specific forfeiture provisions in statute that require payments to the State for failure to file financial reports with the Controller's office. More than 1,100 hours are annually spent by the Controller's office on monitoring submissions and collecting forfeitures. The number of delinquent reports has grown steadily over the past ten years and the Controller's office has identified at least 3,100 entities that are required to but are not actually reporting annual financial data to the Controller's office. This item seeks to provide the Controller's office with the resources to alleviate these issues. The Controller's office believes the growth in delinquent reports is primarily due to the lack of outreach and training by the Controller's office to local governments.

LAO Comment. Given the state's fiscal condition, we recommend denying the request at this time.

B. Actuarial Advisory Support.

Chapter 371, Statutes of 2008 (SB 1123) established an eight-member California Actuarial Advisory Panel (CAAP) to provide impartial and independent information on pensions, other post employment benefits, and best practices for actuarial methodologies and assumptions. CAAP is required to meet quarterly and report to the Legislature annually, on or before February 1. SB 1123 mandated that CAAP be located at the Controller's office and that the Controller's office provide staff support to CAAP. At this date, CAAP has not met and therefore no report was submitted to the Legislature in either 2009 or 2010. The Controller's office sent a letter in April 2009 urging the appointing agencies to make their appointments; to date, five of the eight entities have named their appointments. They indicate that it is not feasible to expect CAAP members to provide their own administrative support and it is also not feasible for the Controller's office to provide support from within existing resources. Therefore, absent approval of this item, the Controller's office indicated that the resulting inaction or delay of action of the appointing agencies and CAAP members will impair CAAP's ability to fulfill its statutory responsibilities.

LAO Comment. Given the state’s fiscal condition, we recommend that the Legislature direct the Controller's office to find the minimum resources necessary within its existing budgetary authority to support this panel. In the future, when state finances improve, the Legislature may wish to consider providing additional resources for this function.
C. Cash Management.

The Controller's office is responsible for the daily reconciliation of the State's General Fund. Workload in this area has increased along with the state's fiscal crises. The increased workload was recognized as part of the 2008 Budget Act with one extra position. The Controller's office states that workload has only increased since that date and the Cash Management Unit has averaged 250 hours per month in overtime work over the past 14 months. Due to continuing demands on the Controller's office's cash management staff over the past year, they are requesting resources to cover workload in areas such as payment accountability, daily cash projections, borrowable/non-borrowable resource accountability, reporting, and improving processes for the future.

LAO Comment. We find that Controller's office staff has managed to handle recent cash crises as well as can be expected. The increased cash management workload for the office is largely cyclical in nature. There always will be certain times during a cyclical economic downturn when additional hours may be needed. Moreover, some elements of this request, such as exhaustive analysis of legislation, are unnecessary or duplicative of existing efforts (for example, the Department of Finance performs many of the same exercises already). The Controller's office should be able to use existing staff and available resources to manage its cash management responsibilities throughout the year. Especially in light of the state's fiscal condition, we recommend denying this request for additional resources.

COMMENTS

Staff largely agrees with the LAO, that while many of the activities requested in this proposal are valid responsibilities, in the current economic time, the state cannot afford to fund them all. In the case of cash management, however, staff believes there is a sufficient urgency to the request for additional resources. While the workload of this division is no doubt cyclical, the current workload being placed upon them is far outside the scope of the normal economic cycle.

AB 5 and AB 14 of the 8th extraordinary session implemented changes to our state cash management practices that reflect the current economic times. These bills placed new responsibilities on the Controller's office to review cash flows on a daily basis to determine which, if any, authorized deferrals must be used to maintain a prudent cash reserve. These responsibilities are crucial to ensuring that the State does not delay payments to entities that are relying on those funds unless absolutely necessary. Without adequate resources, the Controller would have to err on the side of caution, and implement deferrals to ensure the soundness of the state's resources.

As such, staff would recommend providing the two requested cash management positions on a limiter-term basis, after which time their necessity could be re-evaluated.
ISSUE 8: DISASTER RECOVERY

The Governor’s budget requests $206,000 ($64,000 General Fund) to expand the scope of its Disaster Recovery Plan to cover application servers for the Controller’s office “mission-critical server-based systems.”

The Controller’s office currently contracts with the Office of Technology Services, within the Office of the Chief Information Officer, for hundred of its mission-critical mainframe systems and data. The existing contract and plan in place covers all the data housed by the Controller’s office, but it does not include the application servers required to access the data.

This proposal would expand the Controller’s office Disaster Recovery plan to include the application services at the “warm site,” also known as a backup site. This site contains data links and pre-configured equipment necessary to rapidly restart mainframe operations. This updated plan would guarantee the hardware necessary to support specific applications would be available in the event of a disaster. This plan is focused on those critical functions that would need to be operational within 72 hours of a disaster.

COMMENTS

The Controller’s office currently has around 6 programs whose data would be available in the case of a disaster, but would be inaccessible because the application servers are not available. Several of these programs are focused on local government reimbursement. The disbursement of funds and ability to track and monitor those funds is a crucial role of the Controller’s office.
**ISSUE 9: E-CLAIM**

The Governor’s budget requests $444,000 from the General Fund for maintenance and operation of the Local Government e-claims system.

The Controller’s office is required by law to process, review, and pay mandated cost claims received from school districts, local agencies, and community colleges. The total amount claimed by local governments averages between $500-600 million annually.

This system allows local government claimant and their consultants to submit their mandated cost claims electronically. The existing system includes 60 online programs, out of a total of 110.

The system was first used in 2008-09 when 44 claims were received for a total of over $10 million. This number was significantly lower than projected. The Controller’s office cited the inability of locals to file ALL their claims via the new system as the primary reason for low participation rates. This request would move the state towards providing all claims via this system. The Governor’s budget also projects that implementation of this request will result in $11.8 million in cost savings for 2010-11 based on decreased manual filings, allowing redirected staff to return to their auditing workload.

**COMMENTS**

Automating the process will allow more time for desk audits and thorough analysis of claims, and reduce the risk of accepting ineligible, unreasonable, and fraudulent claims caught through vetting features built into the system. However, this system has some performance issues. It will not achieve the cost savings estimate in the current year. The SCO staff indicates this is due to several factors, including staff redirections from desk audits to information technology tasks related to the system, limited programs available for claims because staff was redirected from that task, the system not permitting multi-year filings (which most typical first time claims are) and lack of outreach to claimants about use of the system. The SCO indicates that the information technology staffing resources in this item will be used to overcome these obstacles with the system. The SCO estimates savings of $11.8 million GF in 2010-11 from decreased manual filings.

In order to allow the Controller’s office time to implement these program improvements, the committee may wish to consider 2-year limited-term approval of this request. This will allow the Legislature to review this issue again when these changes have been implemented.
ISSUE 10: APRIL FINANCE LETTER

The State Controller’s Office requests a decrease of $1.1 million to reflect their revised proposal to conduct enhanced claim audits, additional local government and single audit report reviews, and new local government audits in response to ARRA. This revision is consistent with direction provide to the Controller from the Joint Legislative Budget Committee in response to a current year funding request. If this request is approved, it would leave the Controller’s office with $1.3 million for 2010-11, from the Central Service Cost Recovery Fund.

California generally operates its programs on a state-supervised, local-administered basis. This means most ARRA funding awarded to state agencies will flow-through to local governments and other local entities. The federal government, however, typically holds the state agency responsible for the funding it passes on to a local “sub-recipient.” As such, the state must take measures to ensure those funds are used properly. This falls largely upon the Controller’s office (though the new Inspector General appears to overlap to some extent with these responsibilities).

The Controller is also required to review all local government “single audits” required by the federal government. Some entities formerly not required to submit a single audit to the federal government will now be required to do so. This will result in increased workload for the Controller’s office.

COMMENTS

To help reduce costs, pursuant to legislative direction, the Controller’s office will utilize information from single audits, data collection, and information provided by the Bureau of State Audits (BSA), Office State Audits and Evaluations (OSAE) and the new Inspector General (IG), to identify high-value targets for audits and state and local entities receiving ARRA dollars.

This proposal is in line with legislative direction, and matches the LAO proposal for ARRA oversight funding (discussed below).
ITEM ARRA AMERICAN RECOVERY AND REINVESTMENT ACT

ISSUE 1: DISCUSSION REGARDING THE STATE INSPECTOR GENERAL (IG), BUREAU OF STATE AUDITS (BSA), CALIFORNIA RECOVERY TASK FORCE (TASK FORCE), AND THE OFFICE OF STATE AUDITS AND EVALUATIONS (OSAE)

2009-10 Background.

In the final 2009-10 budget act, the Legislature provided a total of $5.7 million of General Fund loans to the Administration and the Bureau of State Audits (BSA) to address state government accountability, transparency, auditing, and oversight activities regarding ARRA. Through Control Section 8.55, it was specified that these loans are to be reimbursed from federal ARRA funding. Funding was specifically provided in the amount of $1.6 million to the Bureaus of State Audits, and $4.1 million to the Department of Finance (DOF) to distribute between the Task Force, IG, and OSAE. Of the $4.1 million, $500,000 is specified for OSAE and the IG each, $400,000 for the Task Force, $2.5 million for tracking and reporting purposes, and $200,000 for operating expenses.

In January of 2010, the Administration requested funding authority in excess of those amounts authorized in the budget and Control Section 8.55. The excess funding was specified as $1.9 million for the State Controller's Office, $1.1 million for the Task Force, and $1.1 million for the IG.

Based on estimated federal oversight/accountability funding, the LAO recommends the Legislature target a total spending level for ARRA oversight of about $7 million per year to avoid committing General Fund dollars for this purpose. In order to achieve this goal, the Joint Legislative Budget Committee (JLAC) rejected the Governor's request for $1.9 million for the controller, $1 million of the request for the Inspector General, and $526,000 of the request for the Task Force. These rejections were based on the provisions of the 2009 budget which did not authorize expenditures by the Controller's office for this purpose, and specifically limited the role of the Inspector General. The Inspector General continues to operate at an increased cost by utilizing borrowed staff primarily from the Department of Finance, but also from CalTrans, DGS, DWR, and EDD.

2010-11 Request.

Similar to 2009-10, the Governor's Budget requests approximately $10 million for ARRA oversight, which will likely necessitate General Fund expenditures to cover a portion of those costs. The LAO maintains its recommendation to limit such costs to approximately $7 million per year.

The 2010-11 request consists of:

Task Force: $3,992,000
IG: $3,388,000
BSA: $1,200,000 (revised)
SCO: $1,311,000 (revised – per SCO – Issue 10 above)
Based on the JLBCs response to the 2009-10 request, the State Controller's Office revised their request to decrease it by $1.1 million. To achieve those savings, they will no longer be able to complete all the tracking of expenditures originally planned in their proposal, and will not be able to collect and report additional data in regards to local allocations. These reductions appear consistent with the desire of the legislature to minimize the general fund impact of these activities.

The Bureau of State Audits (BSA) also requires a revision to their original budget request of $713,000. That request was only for a half year of activities, while their duties will be consistent throughout the entire year. They are now requesting $1.2 million for full year funding. While not requiring action, the BSA has additionally informed staff that they anticipate ending the current year $200,000 under-budget for their ARRA activities.

Accounting for these revisions, the revised request remains $2.5 million over the anticipated amount of federal funds available.

There are 4 primary entities involved in ARRA oversight:

**California Recovery Task Force**

The Task Force is a statewide oversight and coordinating body. They provide advice to ARRA implementing departments, and work to ensure all departments are following general best practices for accountability and following up on corrective actions.

**State Inspector General**

The IG may pursue issues that arise at either the state level or the local level. However, the IG states they are focusing primarily on short term strike force reviews directed towards fraud, waste, and abuse at the sub-recipient level. The IG will select its subjects for review based on a broad range of inputs including, among others, findings identified by SCO, or BSA. Because the IG's responsibilities overlap with existing authority for both the SCO and BSA, any review or audit activity at the local level must be coordinated with SCO, and at the state level with the BSA so they are not both pursuing review of the same entity or program.

**Bureau of State Audits**

In addition to conducting the State's annual single audit, the Bureau is currently tasked with broad authority to review state operations, including their use of federal funds. As the state's independent auditor, they are responsible for producing the overall audit of the state's use of federal funds. They are increasing their focus of audits on those entities expending ARRA dollars to ensure their proper tracking, expenditure and reporting.

**State Controller's Office**

See Issue 10 under the State Controller's Office section above.
LAO RECOMMENDATION

Governor’s Proposal Needlessly Requires General Fund Expenditures. Under the Governor’s proposal, total ARRA oversight and reporting spending in 2010-11 likely would exceed available federal resources by about $2 million to $3 million. This excess of spending would have to be paid from the General Fund. Because the Governor’s proposed ARRA oversight and reporting program exceeds federal requirements, this General Fund spending is unnecessary. Moreover, should the state budget all available federal ARRA oversight dollars now, no federal funding would be available later for (1) unexpected, critical ARRA auditing and compliance requirements for BSA and other departments in 2010-11 or (2) ARRA reporting requirements in 2011-12 and beyond (assuming the federal government allows use of federal funds for these requirements after the end of the federal government’s 2010-11 fiscal year). We strongly recommend, therefore, that the Legislature sharply reduce the Governor’s proposed ARRA oversight and reporting spending to well within the amount likely to be covered by available federal funds in 2010-11.

Recommended Reductions to ARRA Task Force Budget. We recommend that the Governor’s proposed spending for the ARRA task force be reduced by $100,000 to reflect updated administration estimates of staffing costs.

Recommended Smaller Increase in Inspector General Staff Budget. The Governor proposes a huge increase in the Inspector General’s budget: from $898,000 in 2009-10 (consisting of $649,000 for Inspector General staff and $249,000 for the office’s work with OSAE) to $3.4 million in 2010-11 (consisting of $2.8 million for staff and $600,000 for OSAE work). We recommend that the Inspector General’s OSAE budget be eliminated in 2010-11 and that the office’s staff budget be set at $800,000—a $151,000 increase over 2009-10. No statutory action is necessary to continue the work of the existing ARRA Inspector General’s office. Established by executive order—not through a codified statutory action of the Legislature—the office currently is housed for budgetary purposes in the Office of Planning and Research (OPR), which is proposed to be eliminated. We suggest that the Inspector General be housed in the Governor’s Office in 2010-11, which is appropriate, given that the Inspector General was created and appointed solely through gubernatorial action. (Should the Legislature wish to create a permanent non-ARRA Inspector General, as proposed in at least two bills introduced this year, that could be accomplished with a different statute and funding source than those proposed in the Governor’s budget package.)

Recommend Adjustment to Reflect Full-Year BSA Spending. As described above, the administration’s budget proposal included BSA spending only through December 2010. More recent estimates indicate that an additional $500,000 needs to be budgeted to cover BSA’s ARRA-related activities through the end of 2010-11.

Recommend Budgeting for an ARRA “Oversight Reserve.” Under our recommendations, as described above, statewide ARRA oversight and reporting spending would be reduced below the Governor’s proposal by about $2.2 million to $7.2 million in 2010-11. This would leave about $300,000 of potentially available federal funding for other ARRA oversight and reporting activities in 2010-11 and beyond, to the extent permitted by the federal government. In effect, this would be a “reserve fund” for future ARRA oversight and reporting requirements. We recommend that the Legislature include provisional language in the DOF and BSA line items to authorize those entities to request from the JLBC the ability to spend all or a part of the reserve...
funds in 2010-11 if the funds (1) are certified by DOF as likely to be available from the federal government and (2) fulfill a mandatory ARRA oversight, auditing, or reporting need. With any request from DOF or BSA, DOF should be required to report to the Legislature the latest guidance on ARRA oversight and reporting requirements after 2010-11 and whether the federal government will permit the use of any funds unexpended in 2010-11 for those requirements.

**COMMENTS**

Staff concurs with much of the LAO's analysis of the Governor's overall ARRA request.

The BSA's request for full year funding is justified.

The technical change in staffing costs for the Task Force has been confirmed by the Department of Finance.

The LAO recommendation is consistent with the legislative direction provided in the 2009-10 budget to restrict ARRA oversight costs to the availability of ARRA funds for such purposes.

While the IG has been operating with loaned staff to maintain their current level of operation, that same staff was never authorized by the Legislature. In fact, Control Section 8.55 in the 2009-10 budget explicitly stated the desire of the Legislature to limit the size of the IG. The LAO proposal maintains the Legislature's same level of commitment to this office as was provided last year, and actually increases funding.

In regards to permanently creating the Office of the Inspector General, staff concurs with the LAO recommendation to maintain funding for one year only, and operate the office through the Governor's Office. Existing policy bills are the appropriate place to discuss the permanent establishment of a new state entity.

The Legislature remains committed to strong oversight of ARRA expenditures and holding entities accountable, but it may be more effective and prudent to do so utilizing available funds, and entities with existing authority to provide those services.