AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 4
ON STATE ADMINISTRATION
Assembly Member Juan Arambula, Chair

TUESDAY, APRIL 24, 2007
STATE CAPITOL, ROOM 447
1:30 PM

CONSENT CALENDAR (VOTE ONLY)

ITEM	DEPARTMENT	SUMMARY
0520	Secretary for Business Transportation and Housing	$71,460 (General Fund) for Lease Renewal for the Film Commission
0520	Secretary for Business Transportation and Housing	$125,000 (General Fund) to perform audits of 11 financial development corporations.
0520	Secretary for Business Transportation and Housing	$150,000 one time (General Fund) to cover the continued close-out costs for the former TTCA.
0520	Secretary for Business Transportation and Housing	$21,000 (Welcome Center Fund) ongoing augmentation to designate five new California Welcome Centers.
0520	Secretary for Business Transportation and Housing	$6.3 Million (General Fund) reduction from the Tourism Marketing Budget based on the establishment new fees from certain types of car rentals, which is expected generate $25M in 06/07 and $50M in 07/08.
0520	Secretary for Business Transportation and Housing	$180,000 (various funds – no General Fund) to reimburse the CHP for making 2.5 LT positions performing BTH support workload.
0520	Secretary for Business Transportation and Housing	$591,000 General Fund ($150,000 one time) and 3.0 positions to carry out international trade and investment activities required under SB 1513 – Romero.
0845	Department of Insurance	$106,000 (Insurance Fund) to upgrade legal branch positions. **Conform with Senate Actions**
0845	Department of Insurance	$1.3 million (Insurance Fund) to increase local assistance to local District Attorneys to enforce workers compensation fraud.
0845	Department of Insurance	$1.6 million (Insurance Fund) for local assistance to local District Attorneys for enforce automobile insurance fraud.
0845	Department of Insurance	$750,000 (Insurance Fund) for local assistance to local District Attorneys for enforcement of Life and Annuity Consumer Protection Fraud.
0845	Department of Insurance	$1.4 million (Insurance Fund) for local assistance to local District Attorneys for enforcement of automobile insurance fraud in urban areas.
0845	Department of Insurance	Intervenor Compensation Costs with budget bill language – **Conform with Senate Actions**
1690	Seismic Safety Commission	No issues

2120	Alcohol Beverage Control Board	No Issues
2150	Department of Financial Institutions	$377,000 and 3 PYs for increased information technology supervision and management
2150	Department of Financial Institutions	$1.2 million and 8 senior examiner positions to increase E-Banking/Disaster Preparedness.
2150	Department of Financial Institutions	$247,000 (Credit Union Fund) and 2 PYs for increased credit union business loan reviews
2150	Department of Financial Institutions	$95,000 (Financial Institutions Fund) and1 PY for Special Licensee Reviews
2150	Department of Financial Institutions	$137,000 (Financial Institutions Fund) for human resources administration augmentation
7100	Employment Development Department	BCP#4: Automated Collection Enhancement IT Project. The department is requesting $2.8 million ($2.5 million in General Fund) in 2007-08 and 2008-09 and 15.0 existing limited-term positions to continue the second year of a two-year planning and procurement phase for the Automated Collection Enhancement System (ACES). This is a seven year project with a total cost in the range of $93 million.
7100	Employment Development Department	April 1st DOF Letter: The letter requests an increase in budget authority of $2.5 million in 2007-08 (a total of $5 million over three years) to expend a Workforce Innovation in Regional Economic Development (WIRED) grant funds, which was recently awarded to California by the U.S. Department of Labor.
7120	California Workforce Investment Board	$3.6 million (Federal Trust Fund) maintenance budget.
7300	Agricultural Labor Relations Board	$5.1 million (General Fund) maintenance budget.
7350	Department of Industrial Relations	BCP#2: Licensing and Registration Unit Positions. The Division of Labor Standards Enforcement is requesting an augmentation of $408,000 ($385,000 General Fund and $23,000 Car Wash Workers Fund) to add 5.0 positions (2.5 permanent and 2.5 limited-term) to address the increased workload in the Unit.
7350	Department of Industrial Relations	BCP#3: Senior Safety Engineer Position. The Occupational Safety and Health Standards Board is requesting $158,000 (General Fund) in 2007-08 and $150,000 in 2008-09 and subsequent years for 1.0 Senior Safety Engineer positions to address increased workload for the Board.

7350	Department of Industrial Relations	BCP#4: Shift for Workers' Compensation Enforcement. The Division of Labor Standards Enforcement requests to shift $1.1 million in 2007-08 and 2008-09 and 8.8 positions from the General Fund to the Workers' Compensation Administration Revolving Fund. The Department is proposing to use the General Fund savings to fund the following: 1) BCP#1, $449,000 for the IWC (Issue 1 under DIR), 2) BCP#2, $383,000 for staff at the Licensing and Registration Unit, and 3) BCP#3, $158,000 for a position at the Occupational Safety and Health Standards Board.
7350	Department of Industrial Relations	BCP#5 and April 1st DOF Letter: IT Project Re-appropriation/Expenditure Adjustments. The Division of Workers' Compensation requests an appropriation of $9.4 million from 2006-07 to 2007-08, additional funding of $12.4 million for 2007-08 and $3 million in 2008-09 to support the revised project costs of the Electronic Adjudication Management System (EAMS) due to unforeseen delays that occurred in the contract solicitation process and a higher than expected project bid. The April 1st DOF letter makes further adjustments to the expenditure plan and related budget bill changes to account for further delays in procurement. This project was approved in the Budget Act of 2004 and ha a new total cost of $36 million (Workers' Compensation Administration Revolving Fund).
7350	Department of Industrial Relations	BCP#6: Federal Labor Compliance Funding. The Division of Occupational Safety and Health requests an increase in federal fund expenditure authority of $72,000 in 2007-08 and 2008-09 and 1.0 new Associate Safety Engineer position. The cost of this position beyond the amount requested in federal funds ($66,000) will be absorbed by the Targeted Inspection and Consultation Fund.
7350	Department of Industrial Relations	BCP#7: Elevator Plan Checking Unit. The Division of Occupational Safety and Health requests an augmentation of $1.8 million in 2007-08 and $1.7 million in 2008-09 (Elevator Safety Fund) and 16.0 positions to fully implement the elevator safety requirements of SB 1866 (Chapter 1149, Statutes of 2002).
7350	Department of Industrial Relations	BCP#8: Elevator, Ride and Tramway Unit Budget Realignment. The Division of Occupational Safety and Health is requesting to increase its Elevator Safety Account fund authority by $1.4 million. The increase will offset the reduction in General Fund authority of $448,000 and transfer authority of $1 million from the Permanent Amusement Ride Safety Inspection Fund to the Elevator Safety Account.
7350	Department of Industrial Relations	BCP#9: Information Technology Positions. The department is requesting $651,000 (various funds) in 2007-08 and $608,000 in

		2008-09 and 5.6 positions to address ongoing workload issues.
7350	Department of Industrial Relations	BCP#10: Electrician Certification Unit Positions. The Division of Apprenticeship Standards requests an augmentation of $323,000 (Electrician Certification Fund) in 2007-08 and 2008-09 to permanently continue 4.0 positions of 7.0 limited-term positions authorized in 2005-06.
7350	Department of Industrial Relations	BCP#11: Apprenticeship Audit Positions. The Division of Apprenticeship Standards is requesting $339,000 in 2007-08 and $317,000 in 2008-08 (Apprenticeship Training Contribution Fund) and 3.0 Apprenticeship Consultant positions to meet audit requirements of apprenticeship programs.
7350	Department of Industrial Relations	BCP#12: The Division of Worker's Compensation requests a net augmentation of $312,000 (special fund) to fully implement medical treatment utilization reviews. This request provides for 3.0 new positions in the Medical Unit (redirected from the Rehabilitation Unit) and $350,000 for two external contracts.
7350	Department of Industrial Relations	BCP#19: Internal Labor Relations Unit. The department is requesting $223,000 (various special funds) in 2007-08 and 2008-09 and 2.0 positions to augment staffing in the Labor Relations Unit within the Personnel Office. Staff will increase from one to three, which is less than the peak staff level of four staff prior to 2002.
7350	Department of Industrial Relations	BCP# 21: Census of Fatal Occupational Injuries Shift. The department requests to shift the Census of Fatal Occupational Injuries (OFOI) Program from the Division of Labor Statistics and Research to the Division of Occupational Safety and Health (DOSH). The shift would involve 2.0 positions and $112,000 (half federal funds and half General Fund).
8820	Commission on the Status of Women	$34,000 (General Fund) to hire an executive assistant
8820	Commission on the Status of Women	$44,000 (General Fund) for operating expenses and equipment

ITEMS TO BE HEARD

ITEM 0520 SECRETARY FOR BUSINESS TRANSPORTATION AND HOUSING

The Secretary of the Business, Transportation and Housing Agency (BT&H Agency) is a member of the Governor's Cabinet and oversees 16 departments, including the following departments:

● Alcoholic Beverage Control	● Housing and Community Development
● Financial Institutions	● Managed Health Care
● Corporations	● California Highway Patrol
● Real Estate	● Transportation
● Motor Vehicles	

The Governor proposes total expenditures of $27.7 million ($9.5 million General Fund) and 63.6 positions for the Office of the Secretary – an increase of $2.4 million (including a $4.3 million one-time federal fund increase and a $2.1 million General Fund decrease) and 3.0 new positions.

ISSUE 1: SMALL BUSINESS LOAN GUARANTEE PROGRAM/SUDDEN AND SEVERE ECONOMIC DISLOCATION PROGRAM

Governor's Budget. The Governor requests a one-time appropriation of $832,000 General Fund to match $3.6 million in federal funds to establish a new loan guarantee program that would primarily use federal funds associated with the Sudden and Severe Economic Dislocation (SSED) Program. (Note, the administration has reduced its estimate of available federal funds from $4.1 million in the BCP to $3.6 million now). The administration indicates that the Technology, Trade, and Commerce Agency (TTCA), which was abolished in 2003, administered a Sudden and Severe Economic Dislocation Grant Program as a revolving loan program. With the demise of the TTCA, the federal money remains, but cannot be accessed without a General Fund match and a new agency home. The new program would provide loan guarantees to small businesses in areas affected by natural disasters or the loss of jobs from a major employer.

BACKGROUND

Unlike other immediate disaster relief oriented loan and grant programs, this funding requested will be used to reconstruct industries to ensure long term success of job markets hit by major disasters. This program will be designed to provide loan guarantees to directly impacted businesses with working capital to help them recover and become fully operational. As an example, staff understands that funding from this proposal will be directed towards assisting businesses that were affected by the freeze this winter in the Central Valley.

STAFF COMMENTS

Staff feels that this one time minor general fund investment is appropriate considering the federal dollars that it will be leveraging and recommends that it be approved as budgeted.

ISSUE 2: SMALL BUSINESS LOAN GUARANTEE PROGRAM - UNDERCAPITALIZED FINANCIAL DEVELOPMENT CORPORATIONS

The Small Business Loan Guarantee Program is administered by 11 non-profit Financial Development Corporations (FDCs). To fund loan guarantees, FDCs leverage their trust funds at up to a 3/1 ratio to provide loans guarantees to small businesses. Among the individual FDCs there is a great variance of the capitalization levels and subsequently the volume of loan guarantees that the FDCs are able to provide. Below is a list of the 11 different FDCs, their Trust Fund Account balances and their guarantee activities for the first quarter of 2006/07.

Small Business Loan Guarantee Program Activity – First Quarter 2006/07

Name	Trust Fund Account Balance	Guarantees Issued	Guarantee Liability	Leverage Ratio
Cal Capital (Sacramento)	$4,176,192	60	$10,468,001	258.88%
Cal Coastal (Salinas)	6,237,544	25	18,967,591	303.77%
Cal Southern (San Diego)	4,417,436	30	15,239,501	336.72
Hancock (Los Angeles)	2,710,434	35	12,337,851	425.68
Inland Empire (Ontario)	2,061,673	7	4,269,199	221.10
Nor-CAL (Oakland)	3,463,860	43	8,938,782	287.89
Orange County (Santa Ana)	2,164,229	10	4,564,455	191.47
Pacific Coast (Los Angeles)	4,182,072	81	14,132,645	346.76
SAFE-BIDCO (Santa Rosa)	1,071,616	2	3,489,370	359.03
San Fernando (Pacoima)	2,184,888	7	6,143,034	304.08
Valley (Fresno)	5,978,803	30	17,773,150	281.23

STAFF COMMENTS

As noted in the chart above, the levels at which FDCs are capitalized (which drives the volume of loan guarantees issued) varies greatly between each FDC. Staff has heard concerns from the FDCs that capitalization levels are not adequate to provide for the total demand that they encounter from their local small business community. At the hearing, the Office of the Secretary should be prepared to discuss what options the legislature has to increase loan guarantee volume in those regions that are undercapitalized and statewide.

ISSUE 3: FEDERAL FUNDING FOR ECONOMIC DEVELOPMENT PROGRAMS

Since the demise of the Technology Trade and Commerce Agency, the Secretary for Business Transportation and Housing has managed many of our state's small business assistance and economic development programs. The programs that are housed in BTH were specifically transferred to the agency via trailer bill in the 2002/03 while those that were not transferred were deleted from code.

As an agency, TTCA operated several programs that leveraged federal funds for programs to assist small businesses with multiple programs including: Department of Defense grant application assistance; general operations improvements consulting, capital grants and loans; and employee training.

STAFF COMMENTS

Concern has been raised to staff by the public that there are Federal Funds available for local economic development programs that are not being accessed by the state. At the hearing, the Office of the Secretary should be prepared to comment on what it is doing to maximize statewide economic development programs that have federal funds available for them.

Staff understands that in some cases, statutory changes may be needed to allow the Secretary for BTH pursue federal funding for some programs since these programmatic code sections were never transferred to BTH when TTCA was dismantled. Staff recommends that the subcommittee work with the administration to give BTH necessary legislative authority to leverage federal funding for economic development.

ITEM 0559 SECRETARY FOR LABOR AND WORKFORCE DEVELOPMENT

The Labor and Workforce Development Agency (Agency) brings together the departments, boards, and commissions, which train, protect and provide benefits to employees. The Agency is primarily responsible for three different types of functions: labor law enforcement, workforce development, and benefit payment and adjudication. The Labor and Workforce Development Agency includes the Department of Industrial Relations, the Employment Development Department, the Agricultural Labor Relations Board (which is heard in Subcommittee #2) and the Workforce Investment Board. The Agency also provides policy and enforcement coordination of California's labor and employment programs and policy and budget direction for the departments and boards.

The Governor's budget proposes $2.2 million (reimbursements from departments and penalty assessments) and 14.2 positions for the Secretary's budget – a decrease of $135,000 and no change in positions.

ISSUE 1: EMPLOYER / EMPLOYEE LABOR LAW EDUCATION

The administration requests expenditure authority of $15,000 (Labor and Workforce Development Fund) for the purpose of funding employer/employee education efforts. This relates to two bills passed in 2003 and 2004. Because revenue received last year and to-date has exceeded expectations, the subcommittee may want to consider augmenting funding for this program.

BACKGROUND:

Assembly Bill (AB) 276 (Chapter 329, Statutes of 2003, Koretz): This bill increased penalties for violations of specified provisions of the Labor Code and provides that 12.5 percent of the employer penalties for failure to pay wages or unlawfully withholding wages shall be placed in a fund within the Agency to be used to educate employers about state labor laws. The remainder of the penalty is to be deposited in the General Fund. The analysis for AB 276 estimated annual total penalty revenue of $800,000, with about $100,000 of that available to the Agency for education efforts.

Senate Bill (SB) 1809 (Chapter 221, Statutes of 2004, Dunn): This bill allows employees to bring civil actions to recover civil penalties provided for violations of the Labor Code. These provisions are called the Private Attorneys General Act of 2004. The statute divides the penalties collected between the Agency (75 percent) and the aggrieved employee (25 percent). The Agency share is specified for education of employers and employees about their rights and responsibilities under the Labor Code. No estimate of civil penalty revenue was included in the analyses of SB 1809.

COMMENTS:

The administration has been more conservative in its estimates of program revenue than the analyses associated with the enacting legislation. Last year, the administration proposed ongoing expenditure of $15,000. However, when a single penalty payment bumped 2005-06 revenue over $100,000, the administration agreed to a one-time expenditure increase to $100,000 in 2006-07. The administration has built $15,000 into the 2007-08 budget; however, recently-paid penalties have resulted in 2006-07 revenue above $500,000. Due to higher revenue for this special fund program, the subcommittee may want to consider increasing the program up to about $200,000 on an ongoing basis. This ongoing amount could be further adjusted in future years if program revenue changes.

Revised Administration Plan: Recognizing the new revenue, the administration has recently prepared a $211,000 expenditure plan for implementation in 2008-09. The administration believes it is too late in the budget process for them to prepare a Finance Letter to implement the new expenditure plan in 2007-08. The new plan would 1) establish a toll-free 800 number that workers could call to get information about worker rights and labor laws; 2) create a limited term position to respond to questions on the toll-free line; and 3) create a bus advertising campaign to tell workers about the toll free number.

Budget staff recommends the subcommittee members to permanently augment this item from $15,000 to $211,000 to accelerate the administration's new labor-law education plan by one year from 2008-09 to 2007-08. This action would be consistent with the Senate Sub 4 action taken on April 12th.

ITEM 2100 DEPARTMENT OF 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.

ISSUE 1: RECRUITMENT AND RETENTION

ABC operates multiple levels of enforcement activities of business and persons engaging in the distribution or sale of alcoholic beverages. These activities can include performing compliance visits to ABC licensed premises, complaint investigation, and minor decoy operations.

STAFF COMMENTS

From discussions with the department, staff has concerns that though ABC is experiencing annual increases in liquor licenses renewal by 1000 -1100 and new priority license applications increase by approximately 200 each year, recruitment and retention issues with enforcement staff prevented the department from maintaining adequate levels of enforcement staff. Staff understands that there is about a 30 percent vacancy level in enforcement positions for the staff, a problem that is exacerbated by an inability to recruit qualified peace officers and retain them for multiple years.

Although the state is facing recruitment and retention problems in multiple agencies, the ABC is unique because it has statutory authority to administratively increase its own revenue to fund enforcement activities as necessary. At the hearing, the department should report to the subcommittee on:

- What are the current peace officer staffing levels and vacancy rates?
- What is the department's plan to reduce vacancies in their peace officer positions?
- How many years is the average peace officer retention?
- What options are available to the legislature to fill peace officer vacancies and improve retention?
- What is the expected balance of the Alcohol Beverage Control fund for the next three years?
- Does the department expect to use its authority to increase revenue for this fund to help recruitment and retention issues?
- What role do local law enforcement agencies play in ABC's enforcement activities?

ITEM 2180 DEPARTMENT OF CORPORATIONS

The Department of Corporations is California's Investment and Financing Authority, and has exclusive authority to bring both civil and administrative actions under the laws subject to the jurisdiction of the California Corporations Commissioner.

ISSUE 1: STATE CORPORATIONS FUND – EXCESSIVE FUND BALANCE.

Pursuant to the requirements of SB 742 (Ch. 118, St. of 2001, Escutia), the department is required to reduce the fund balance in the State Corporations Fund to no more than a 25 percent reserve above annual expenditures by June 30, 2007. According to the Governor's Budget, the department will have a fund balance of $15.1 million on June 30, 2007, which represents 45 percent of 2006-07 expenditures. SB 742 also requires annual November 1 reports to the Legislature on fee levels and the projected fund balance. The 2006 report has not, to date, been submitted.

LAO COMMENTS

In the *Analysis of the 2007-08 Budget Bill*, the Legislative Analyst's Office withholds recommendation on the department's budget pending a report on fees at the budget hearing because the department has not submitted the SB 742 report. The LAO indicates that, generally, a 5-percent fund balance is a prudent reserve. The LAO also notes that fine and penalty revenue, unlike fees, can be transferred to the General Fund. A transfer to the General Fund of $1.5 million was approved in the 2004 Budget Act; however, no transfers have been made since then. The Legislature may want to consider amending the budget bill to transfer 2005-06 and 2006-07 fine and penalty revenue to the General Fund.

Administration Response to the LAO: The administration indicates it is withdrawing the proposal in the Governor's Budget to repay $6.0 million of the outstanding $18.5 million General Fund loan on June 30, 2007. This would bring the projected fund balance on June 30, 2007 to $9.1 million – about 27 percent of expenditures. However, the department also indicates that 2006-07 fine and penalty revenue has exceeded the budgeted amount by about $2.7 million, which would make the June 30, 2007, fund balance about $11.8 million (about 36 percent of expenditures).

STAFF COMMENT

The Subcommittee may want to ask the department to report on when it will be conducting its statutorily required SB 742 fee report?

ISSUE 2: CALIFORNIA STATE AUDITOR JANUARY 2007 REPORT

California State Auditor January 2007 Report. In January, the State Auditor released an audit titled: *Department of Corporations: It Needs Stronger Oversight of Its Operations and More Efficient Processing of License Applications and Complaints*. Among other findings, the audit revealed flaws in department statistics and data gathering processes, and delays in resolving complaints, performing examinations, and processing applications. Below is a complete list of the Auditor's findings:

- Corporations' current fee structure results in certain licensees subsidizing the administrative costs for others. For example, revenues from securities fees have exceeded the related service costs by $22.2 million over the last seven years.
- Corporations has taken important steps in strategic planning for its operations, however, these efforts are undercut by inaccurate statistical information about its actual performance as reported in its monthly and quarterly performance reports.
- Corporations does not always process applications within the time limits set by state law. In fact, for applications submitted between January 2004 and May 2006, the average processing time exceeded the time allowed by law for many of the application types we reviewed.
- Although there is no legal requirement dictating the length of time Corporations has to resolve complaints, we found examples of unnecessary delays in a sample of complaints we reviewed.
- Corporations has three primary information systems for capturing complaint related data; however, none of them are reliable for determining the number, type, and status of its complaints because the systems contain too many blank fields, duplicate records, and errors.
- Corporations did not conduct required examinations of at least 170 licensed escrow offices and 899 licensed finance lenders within its four-year goal.

Staff Comments. Since the release of the audit, the department has begun to address the findings of the Auditor with a multi step action plan. On areas that staff would like to address would be that the department has not, contrary to law, conducted at least 170 (37 percent) of its required examinations of escrow office licensees within the last four years. In addition, it has yet to conduct examinations for 899 (35 percent) of eligible finance lender licensees within its four-year goal. The Auditor found cases of long delays in processing applications and resolving complaints. Is the department exploring the Auditor’s recommendation to assess the need for additional staff?

ISSUE 3: INCREASED STAFFING – LENDER FIDUCIARY PROGRAM

Governor's budget. The Governor's budget is requesting to convert three limited term examiner positions to permanent for the Lender Fiduciary Program. The Legislature approved BCP #3 for 2005-06, which added 16 additional Examiners (seven of these were limited-term) to the Lender-Fiduciary Program. The administration is requesting to permanently continue three of the seven limited-term positions. However, the workload data from the department suggests a total of six positions (three more than requested) would be needed to perform all the anticipated 2007-08 workload. The department indicates fewer positions than the stated need are being requested because it is hoped that a higher proportion of trained staff will increase efficiencies.

STAFF COMMENT

The Audit found that Corporations did not conduct examinations of 170 licensed escrow offices within the statutorily-required timeframe and did not conduct examinations of 899 licensed finance lenders within its four-year goal. Given the examination deficiencies outlined in the Auditor's report, and the resulting gaps in consumer protection, the Subcommittee may want to consider whether it would be appropriate to double the request – and provide six, instead of three, new permanent positions. Note, a total of six new positions are needed to meet the workload need as outlined in the budget change proposal.

ISSUE 4: INCREASED STAFFING – INVESTMENT PROGRAM

The Governor's budget. The administration is requesting to add two new Staff Service Analyst positions. These positions would perform analytical duties currently performed by Examiner positions, and thereby allow the Examiners to spend additional time in the field. The workload data from the department suggests a total of 34.3 positions (32.3 more than requested) would be needed to perform all the anticipated 2007-08 workload. The department indicates fewer positions than the stated need are being requested because it wants to further assess efficiencies to get a clearer picture of the true ongoing workload and future staffing needs.

Staff Comment: Given examination deficiencies outlined in the Auditor's report, and the resulting gaps in consumer protection, the Subcommittee may want to consider whether it would be appropriate to add positions beyond the administration's request. Note, a total of 34.3 new positions are the actual workload need according to the workload data in the budget change proposal.

ISSUE 5: INCREASED STAFFING – INVESTIGATOR POSITIONS

In 2003-04, Corporations eliminated all 14.0 of its Investigator positions as part of the 2003 Budget Act Control Section 4.10 process which required a statewide reduction of 16,000 permanent positions, as specified. Newspaper reports indicate that the cases the department referred for criminal prosecution declined from 27 in 2002 to none in 2004. Without Investigator positions, this function falls to local law enforcement and the State Attorney General, who received no additional funds to perform this activity. Since the elimination occurred through Control Section 4.10, the Legislature did not consider this reduction through the Budget Subcommittee process. Last year, this Subcommittee re-classed three positions to reestablish the investigative function at the department.

STAFF COMMENT

The audit indicates that as of January 2, 2007, Corporations did not have any Investigator positions filled; however, conditional offers were outstanding to three individuals. The Subcommittee may want to ask the administration about their progress filling these positions and when they will come forward with a long-term staffing proposal for Investigators.

ITEM 7100 EMPLOYMENT DEVELOPMENT DEPARTMENT (EDD)

The Employment Development Department (EDD) is responsible for administering the Unemployment Insurance (UI) and Disability Insurance (DI) programs. The department collects from employers (1) their UI contributions, (2) the Employment Training Tax, and (3) employee contributions for DI. It also collects personal income tax withholding. In addition, it pays UI and DI benefits to eligible claimants. The department also, with the assistance of the State's Workforce Investment Board (WIB), administers the federal Workforce Investment Act (WIA) program, which provides employment and training services. In addition, local area WIBs partner with EDD's Job Services program to provide job matching and training services to job seekers and employers.

The Governor's budget proposes expenditures totaling $10.8 billion from all funds for support of EDD in 2007-08. This is a decrease of $332 million, or three percent, below current-year estimated expenditures. The decrease is primarily the result of lower estimates of UI and DI benefits for the budget year. The budget also proposes $44.4 million from the General Fund in 2007-08, which is an increase of $13.4 million (43 percent) compared to the current year. This increase is primarily the result of realigning some shared costs for EDD's tax collection functions from special and federal funds to the General Fund.

Employment Development Department: Summary of Expenditures by Fund

(Dollars in Thousands)

	Actual 2005-06	Estimated 2006-07	Proposed 2007-08
General Fund	$22,064	$30,984	$44,376
Benefit Audit Fund	12,831	14,473	14,621
Contingent Fund	74,445	78,751	52,835
Employment Training Fund	67,650	58,791	59,200
Unemployment Compensation Disability Fund	3,985,949	4,649,226	4,519,591
Consolidated Work Program Fund	451,077	486,061	459,791
Unemployment Administration Fund	478,336	521,667	519,311
Unemployment Fund	4,529,562	5,176,629	5,023,681
Schools Employee Fund	79,211	88,108	80,126
Reimbursements	15,190	23,708	22,916
Total Expenditures (All Funds)	**$9,716,315**	**$11,128,408**	**$10,796,448**

MAJOR BUDGET ADJUSTMENTS:

The EDD budget reflects adjusted benefit expenditures in the current year and budget year. The adjustments are a result of recent benefit claim levels and of the October 2006 forecast of future claims. The department will submit a revised forecast for benefit expenditures as part of the May Revision. The amounts included in the January Governor's Budget for 2006-07 benefit payments include a 10-percent buffer for uncertainty.

- **Unemployment Insurance (UI).** Benefits are proposed to decrease by $475.0 million in 2006-07 (excluding the buffer) and decrease by $157.4 million in 2007-08 (both relative to the 2006 Budget Act base). Additionally, operations expenditures are proposed to decrease by 216.4 personnel years and $16.6 million in 2006-07 and decrease 225.6 personnel years and $18.0 million in 2007-08.

- **Disability Insurance (DI) Program.** Benefits are proposed to increase by $91.1 million in 2006-07 (excluding the buffer) and increase by $382.0 million in 2007-08 (both relative to the 2006 Budget Act base). Additionally, operations expenditures are proposed to increase by 36.6 personnel years and $2.6 million in 2006-07 and increase 63.4 personnel years and $5.1 million in 2007-08.

- **School Employees Fund Program.** Benefits are proposed to decrease by $10.0 million (including the buffer) in 2006-07 and decrease by $17.8 million in 2007-08. No staffing changes are requested in either year.

- **Workforce Investment Act (WIA) Program.** WIA expenditures are proposed to decrease by $5.7 million in 2006-07 and decrease by $30.6 million in 2007-08.

COMMENTS:

The subcommittee may want ask the department if and how the forecast has changed since October of last year and if there are any anticipated adjustments for the May Revision revised forecast.

ISSUE 1: DISABILITY INSURANCE BRANCH AUTOMATION PROJECT-PHASE 3 (BCP#1)

The department is requesting a one-time augmentation of $1.6 million and 6.6 positions in 2007-08 (Disability Insurance Fund) to fund the second year of a four-year information technology project that is estimated to cost a total of $28.9 million. The department indicates that the system would provide greater access to services for claimants, medical providers, and employers.

BACKGROUND:

In 2006-07, the Legislature approved $1.8 million and 6.3 positions to begin the implementation of this project. These funds were requested for the department to hire consultants to perform project oversight, independent verification and validation and a procurement assistance vendor to assist in the development of a Request for Proposal (RFP) reengineering phase, and begin the Special Project Report (SPR).

This is a multi-year project. Additional funding is and will be requested as follows:

Fiscal Year	Positions	Funding	Disability Insurance Fund
2007-08	6.3	$1.6 million	one-time
2008-09	24.8	$10.9	one-time
2009-2010	28.6	$28.6	one-time
2010-2011	12.4	$12.4	ongoing
4 Year project	**72.1**	**$28.6 million**	

The funding requested in 2007-08 will be used as follows:

- Continue funding for Independent Project Oversight (IPO) consultant that will be tasked with monitoring and reporting support functions through January 2010.
- Continue funding for a consultant to perform Independent Verification and Validation services that include monitoring vendor contract compliance, reviewing deliverables for conformity to requirements, monitoring vendor efforts, and reviewing software products and business process designs.
- Completion of the business process re-engineering during the planning and procurement phase. The results of the business process re-engineering will be taken into consideration in the design of the RFP.
- Continue funding for the Procurement Assistance consultant to assist the Department in refining the RFP.
- Complete and submit an updated SPR to DOF.

COMMENTS:

The Disability Insurance Automation Project – Phase 3 will replace and improve functionality currently provided from key-data-entry personnel and two legacy IT systems. With expected efficiencies that would result in the elimination of 67 positions upon full implementation, the Feasibility Study Report (FSR) indicates a net cumulative project cost that falls to $9.5 million by 2011-12. With annual net savings of almost $9.6 million in 2011-12, the FSR implies this project should pay for itself by around 2013-14.

Budget staff recommends approval of the funding request. Since this is a project that was approved by the subcommittee last year, members may have questions as to the progress of the project.

ISSUE 2: TAX SHARING RATIO CHANGE (BCP#2) AND APRIL 1ST DOF LETTER

The issue for the subcommittee to consider is the Governor's proposal to increase EDD's budget by $13.4 million General Fund to realign the shared costs of tax collection from special and federal funds to the General Fund.

BACKGROUND:

EDD is one of the largest tax collection agencies in the nation. The responsibilities of the department include handling all administrative, education, customer service, and enforcement functions of the audit and collection of Unemployment Insurance (UI), Disability Insurance (DI), Employment Training Tax, and Personal Income Tax (PIT) withholding.

The department requests a funding shift for tax collection workload. The shift would result in a net-zero change in expenditures, but would increase General Fund expenditures by $13.5 million and reduce Disability Insurance and Employment Training Fund expenditures by $11.1 million and $2.4 million respectively. EDD collects taxes in the following areas: Unemployment Insurance, Disability Insurance, Employment Training, and employer-withholdings for Personal Income Tax. This proposal would shift the funding for the tax-collections positions to reflect the pro rata workload for each tax. The April 1st DOF letter is a technical correction related to this proposal.

COMMENTS:

Given the current status of the General Fund, the LAO raised the question of whether the $13.4 million fund augmentation could be delayed for a year or longer. EDD responded that the funding shift would have to happen eventually.

Budget staff recommends that this issue be kept open pending May Revise when the subcommittee will have more accurate information on the status of the General Fund.

ISSUE 3: JOB SERVICES PROGRAM REDUCTION (BCP#5)

The Governor's proposed budget includes a $27.1 million (Contingent Fund) reduction and the elimination of 271 positions to EDD's Job Services Program and makes a corresponding transfer of this funding to the General Fund. The program would continue at a reduced level of activity using $138.3 million in federal funds and $14.8 million in reimbursements. This proposal represents a cut of about 16 percent to the program. In addition to the proposed cut, EDD did not receive an augmentation for the cost-of-living (COLA) salary increases related to recent bargaining unit contracts. EDD indicates they would need an additional $5.0 million to fund these COLAs for the remaining positions. Without this funding, EDD will have to hold an additional 47 positions vacant (beyond the eliminated positions). Approximately 80 percent of the positions that would be eliminated will be positions in local offices that provide direct program services state-wide. The balance of eliminated positions will be indirectly funded support positions in program review, administration, and information technology classifications.

BACKGROUND:

Since the mid-1930's, the Job Services Program has provided a variety of services designed to facilitate a match between employers and job seekers, including specialized services for job seekers needing additional assistance. Special client groups include the disabled, the long-term unemployed, welfare recipients, parolees, veterans and youth.

Since 1983, the EDD Contingent Fund has been utilized to supplement federal funds in supporting the Job Services Program. The department indicates the job service centers annually provided services to more than one million job seekers and 53,000 employers. Many job services centers are cooperative ventures with local entities, including local Workforce Investment Boards, and county CalWORKs offices.

Last year, the administration proposed, and the Legislature approved, an augmentation in EDD Contingent Funds of $6.9 million to maintain 93.0 positions that would have otherwise been eliminated due to federal cuts. In the current year, the Contingent Fund helps to support the basic Job Services Program ($23.1 million), Veteran's Program ($1.2 million), and the limited-term Job Services 4 UI Program ($2.8 million).

Decreased Federal Support. The decline in federal job funds was summarized last year in a letter dated March 17, 2006, that the Governor wrote to Congressman Ralph Regula, then the Chairman of the Subcommittee on Labor, Health and Human Services Education and Related Agencies, Committee on Appropriations:

Workforce Investment Act (WIA) Programs – Since the initial appropriation for the Workforce Investment Act (WIA) in 2000, the amount allocated by Congress has decreased in each of the last six program years. The decrease in California for WIA's *three funding streams has been $196.1 million, over 31 percent. Appropriations for the Wagner-Peyser Act have also decreased in the last five years. The total decrease for California's Job Services program equates to nearly 9 percent. These constant reductions of federal appropriations significantly impair California's ability to provide employment and training services at the level necessary to meet the needs of California's changing and expanding workforce and economy. Maintaining funding for federal WIA programs at the current level is a priority for California.*

COMMENTS:

LAO Recommendation. In the Analysis of the 2007-08 Budget Bill, the LAO withholds recommendation pending receipt of supporting information from the administration. On April 5, 2007, EDD provided the LAO and budget staff a detailed Job Services Reduction Plan that indicates positions eliminated by region and office. Attachment I to this agenda is the EDD summary table for position cuts at each office excluding the 54 central administrative positions that would also be cut.

In the BCP, EDD states that the proposed elimination of the Contingent Fund supplement to the Job Services Program will result in fewer program staff to provide services. However, job seekers will still be able to access employment services state-wide at One-Stop Career Centers where the vast majority of program staff are employed. In addition, job seekers will also be able to self-serve via CalJOBS, EED's internet job search website. Veteran's services will not be reduced, as staff currently providing regular job services functions will be redirected to provide veteran services in order to maintain service levels. In addition, EDD will need to reduce the number of sites in which it provides job services.

Budget staff recommends that this item be held open pending May Revise. However, as the subcommittee considers this proposal, members should request more specific information on the implementation of staff and site reductions. In addition, the subcommittee should request information on how this proposal relates to the CalWORKs proposed reduction.

ISSUE 4: WORKFORCE INVESTMENT ACT (WIA) DISCRETIONARY FUNDS EXPENDITURE PLAN

The issue for the subcommittee to consider is the Governor's proposed WIA discretionary funds expenditure plan.

BACKGROUND:

The federal WIA of 1998 replaced the Job Training Partnership Act, which provided employment and training services to unemployed and disadvantaged workers. The goal of WIA is to strengthen coordination among various employment, education, and training programs. The administration estimates the state will receive approximately $413.3 million in federal WIA funds for expenditure in the 2007-08 budget. Under federal law, 85 percent of WIA funds are allocated to local Workforce Investment Boards for employment and training services. The remaining 15 percent (about $62 million) is available for state discretionary purposes such as administration, statewide initiatives, and competitive grants for employment and training programs. The LAO produced the chart on Attachment II that shows how proposed 2007-08 allocations differ from 2006-07.

COMMENTS:

In their Analysis of the 2007-08 Budget Bill, the LAO recommends that the Legislature reallocate federal WIA funds to shift $3.4 million from new regional collaboratives to existing parolee employment programs, and adopt related budget bill language. Attachment II of this agenda is an LAO table that summarizes the proposed funding allocation. Regional collaboratives are training projects developed at a regional level by a partnership of business, labor, foundations, and other public agencies. The LAO indicates regional collaboratives were tried in the 1990s and mostly fell short in meeting their job placement goals. The shift of the $3.4 million from Regional collaboratives to the parolee programs would not change the mandated level of parolee programs, but would result in a General Fund savings of the same amount.

Budget staff understands that there may be a WIA adjustment at May Revision. As such, the recommendation is to hold this item open until then.

ISSUE 5: DISLOCATED WORKERS ALLOCATION FORMULA (INFORMATIONAL ITEM ONLY)

The subcommittee Chair has requested information on the potential changes to the dislocated workers allocation formula.

BACKGROUND:

On January 2, 2007, EDD released a report titled "Consideration of Potential Changes to the Formula Used to Allocate California's WIA Dislocated Worker 60 Percent Funds."

Executive Summary
Federal law requires that each state allocate WIA funds to Local Workforce Investment Areas (LWIAs) using a formula prescribed by the Governor. Over many years, local areas have raised concerns about California's existing formula not representing the target population and being overly volatile from year to year. Federal changes, in 2004, in the manner of collecting data for one of the current formula factors, mass layoffs, exacerbated those concerns and led an informal work group, formed in late 2005 by the California Workforce Investment Board (State Board) and EDD to recommend that the State prepare a "white" paper that would explore issues with the current formula and identify potential alternatives. This report is the result of that recommendation.

The report presents information on the sources, applications, pros and cons and concerns associated with various alternative data factors for the allocation formula. Based on information in this report, a formal committee established in August 2006 by the State Board made recommendations to change the formula in a manner that better reflects the incidence of dislocation in California's LWIAs, and the impact of that dislocation on California's communities.

The Committee's recommendation would change California's dislocated worker sub-state allocation formula to be based on the following factors and weights:

FACTOR	WEIGHT
Long-Term Unemployment Insurance Claims	40 percent
Mid-Term Unemployment Insurance Claims	30 percent
Short-Term Unemployment Insurance Claims	10 percent
Long-Term Civilian Unemployment	20 percent

The recommended formula will better target resources to where the dislocated workers reside, and will dramatically reduce year-to-year funding volatility. At their meeting on November 30, 2006, the State Board unanimously accepted the Committee's recommendation.

COMMENTS:

California workforce Investment Board representatives will present on the report's findings and recommendations.

ITEM 7350 DEPARTMENT OF INDUSTRIAL RELATIONS (DIR)

The objective of the Department of Industrial Relations (DIR) is to protect the workforce in California; improve working conditions; and advance opportunities for profitable employment. The department enforces workers' compensation insurance laws and adjudicates workers' compensation insurance claims; works to prevent industrial injuries and deaths; promulgates and enforces laws relating to wages, hours, and conditions of employment; promotes apprenticeship and other on-the-job training; assists in negotiations with parties in dispute when a work stoppage is threatened; and analyzes and disseminates statistics which measure the condition of labor in the state.

The Governor's budget proposes $384.5 million ($68.2 million General Fund) and 2,739.0 positions, an increase of $21.8 million (including a General Fund decrease of $211,000) and 31.9 new positions.

Department of Industrial Relations: Expenditures by Program

(Dollars in Thousands)

	Estimated 2006-07	Proposed 2007-08
Self Insurance Plans	$3,371	$3,778
Mediation/Conciliation	2,358	2,359
Workers' Compensation	166,474	179,024
Commission on Health and Safety and Workers' Compensation	3,132	3,080
Division of Occupational Safety and Health	89,509	96,652
Division of Labor Standards and Enforcement	48,909	50,382
Division of Apprenticeship Standards	10,478	11,207
Division of Labor Statistics and Research	4,008	3,904
Claims, Wages and Contingencies	34,132	34,132
Administration	30,205	31,366
Distributed Administration	(30,205)	(31,366)
Total Expenditures (All Funds)	**$362,731**	**$384,518**

ISSUE 1: INDUSTRIAL WELFARE COMMISSION (IWC) (BCP#1)

The issue for the subcommittee to consider is the proposed funding request to support the IWC.

BACKGROUND:

The department requests an augmentation of $449,000 General Fund to restore funding and 3.0 positions for the Industrial Welfare Commission (IWC). In 2004-05 the Legislature eliminated funding and staff for the Commission; however, the statutory responsibilities of the Commission were not amended. Among other responsibilities, the Commission is required to conduct a full review of the adequacy of the minimum wage at least once every two years.

COMMENTS:

The Legislature deleted funding for the IWC in 2004-05 because it had not fulfilled its statutory obligation to review the adequacy of the minimum wage. The department indicates that since the IWC was de-funded, it has redirected staff from other areas to provide staff support to the Commissioners. Aside from the minimum wage determination, the IWC may also consider petitions to adopt, amend, or appeal wage order regulation. The administration indicates that the General Fund cost of this proposal is offset by savings generated by BCP #4.

ISSUE 2: DIVISION OF WORKERS' COMPENSATION (DWC) (BCPs # 13, 14, 15 AND 16)

The Division of Workers' Compensation (DWC) monitors the administration of workers' compensation claims and provides administrative and judicial services to assist in resolving disputes that arise in connection with claims for workers' compensation benefits. Legislation enacted in 2003 and 2004 resulted in significant changes to the workers' compensation system. Last year, the administration reported that charged rates were $6.46 for every $100 in payroll in July of 2003, but by September of 2005 those rates were down to $4.42 per $100 in payroll – an actual reduction of 31.6 percent. While the program changes resulted in significant savings for employers, they also added new workload for the Division – employment has increased from 910 positions in 2002-03 to 1,145 positions in 2006-07.

BACKGROUND:

The Department requests approval of four budget change proposals to permanently extend 31.0 limited-term (LT) positions added in 2004-05. These LT positions are associated with SB 899 (Chapter 34, Statutes of 2004) and other workers' compensation reform legislation of that period. Of the 37.5 three-year LT positions added in 2004-05 for workers' compensation reform, this request would continue the 31.0 positions that did not get eliminated through vacant position reductions. The Department indicates the positions were originally made limited term because the long-run workload from Workers' Compensation Reform was difficult to assess in 2004-05. Based on workload data compiled over the past two years, the department feels the realized workload justifies the permanent extension of these 31.0 positions. Funding for these positions would come from the Workers' Compensation Administration Revolving Fund.

- **Uninsured Employers Benefit Trust Fund Unit Positions (BCP #13).** The Governor requests $784,000 and the continuation of 7.0 Workers' Compensation Consultants and 2.0 Office Assistants. The Uninsured Employers Benefit Trust Fund Unit ensures that injured workers whose employer did not provide workers' compensation protection as required by the law still receive benefits. Statistics from the department show that overall new claims increased by 44 percent from 2003-04 to 2005-06, and that that the average caseload per examiner is already 75-percent above the industry average.
- **San Bernardino Information Service Center Positions (BCP #14).** The Governor requests $787,000 and the continuation of 3.0 Program Technicians (including one supervisor) and 4.0 Office Assistants. The San Bernardino Information Service Center provides phone assistance to users of the workers' compensation system. The Department indicates that call volume has stayed high, and was recently measured at 42 percent above pre-SB 899 levels. The department has also worked to improve wait times, and the average wait times in early 2006 were 6 to 10 minutes – down from 20 to 25 minutes in 2005.

- **Medical Unit Positions (BCP #15)**. The Governor requests $381,000 and the continuation of 3.0 Workers' Compensation Consultants and 9.0 Office Assistants. These positions are requested to support the review requests for a Qualified Medical Evaluator (QME) panel. With the enactment of SB 899, injured workers are now mandated to go through the process of requesting a QME panel when the sides cannot agree on an Agreed Medical Examiner to resolve medically-determined issues such as permanent disability, apportionment, future medical treatment, etc. The department indicates that actual workload has been above estimates and is not expected to fall significantly in the future.
- **Audit Unit Positions (BCP #16).** The Governor requests $200,000 and the continuation of 1.0 Staff Services Analyst and 2.0 Office Technicians. The Audit unit reviews insurers, self-insured employers, and third-party administrators to insure they meet their statutory responsibilities. The department indicates the current staffing level should be continued to rid the system of the egregious violators. While the positions at issue are not auditors, they monitor and compile databases of required filings that help identify violators and prepare evidentiary documents.

COMMENTS:

Since the workers' compensation reform is fairly recent, budget staff requested to present these budget requests before the subcommittee to find out about the status of these reforms and how these request will aid in their implementation.

ITEM 8885 COMMISSION ON STATE MANDATES

The task of the Commission on State Mandates is to fairly and impartially determine if local agencies and school districts are entitled to reimbursement for increased costs mandated by the state. The commission was created as a quasi-judicial body to determine state mandated costs and consists of the Director of Finance, the State Controller, the State Treasurer, the Director of the Office of Planning and Research, a public member with experience in public finance, and two additional members from the categories of city council member, county supervisor, or school district governing board member, appointed by the Governor and approved by the Senate. The budget proposes General Fund support of $1.7 million in fiscal year 2007-08 and 13.6 personnel-years (PYs) of staff for support of the commission. These amounts are the same as in the current year.

No General Fund Provided for 2007-08 Local Government Mandate Claims. The bulk of the commission's budget is for local assistance to reimburse local governments for their costs of carrying out state-mandated local programs. The budget proposes a total of $11.5 million for these payments in 2007-08, all from special funds (primarily the Motor Vehicle Account in the State Transportation Fund). This is a relatively minimal amount compared with a total of $404.1 million for mandate reimbursement payments in the current year, of which the bulk--$402.4 million—was from the General Fund. The Governor's budget provides no General Fund money to pay local government mandated cost claims that will be filed in 2007-08. The Legislative Analyst's Office (LAO) estimates that General Fund local government mandate claims for 2007-08 will total around $150 million, excluding any AB 3632 costs above the categorical funding (see below).

The budget continues to suspend 28 mandates that are suspended in the current year (most of which have been suspended for some time).

AB 3632 Mental Health Services for Students. The Governor's budget for the Department of Mental Health includes $52 million (General Fund) as categorical funding to counties (rather than mandate reimbursement) for this program in 2007-08, plus $69 million in additional federal special education funding budgeted in the Department of Education. The 2006-07 Budget also provided $52 million for categorical funding in 2006-07 plus an additional $66 million to pay mandate claims for 2004-05 and 2005-06, prior to the provision of any categorical funding. However, any excess county costs may be claimed under the mandate reimbursement process.

K-14 Education 2007-08 Mandate Costs Also Essentially Unfunded. Funding to pay K-14 education mandate costs is not included in the commission's budget, but is appropriated to the Department of Education as part of Proposition 98 funding. However, the budget essentially follows the same funding policy for K-14 mandate costs. It defers payment of all but $4 million of approximately $185 million of annual General Fund Proposition 98 mandate costs. Because K-14 mandate payments are included within the Proposition 98 requirement, they generally do not have any additional effect on the state budget. Instead, mandate reimbursements to schools and community colleges act to reallocate Proposition 98 funding from other education programs or among the individual school districts and community college districts.

ISSUE 1: DEFERRED PAYMENT OF 2007-08 GENERAL FUND MANDATE CLAIMS

As noted above, the Governor's budget provides no General Fund money to pay local government mandated cost claims that will be filed in 2007-08 for 38 local government mandates that are subject to Proposition 1A and not suspended. Instead, the budget proposes to pay these claims in 2008-09. The administration points out that its proposal would not violate the requirements of Proposition 1A.

Proposition 1A Pay-or-Suspend Rule for Local Governments. Proposition 1A, adopted by the voters in November 2004, generally requires that the state either fund mandate reimbursement claims that have been filed and approved as of the time that the budget is considered or suspend any mandate that is left unfunded. That is, the budget must appropriate money to pay claims filed in the previous year, and which the state already has in hand before it may continue to require local governments to incur costs for those mandates in the following year. There are a number of exceptions. The "pay or suspend" rule does not apply to claims for costs incurred prior to fiscal year 2004-05 (these "deferred" payments are being paid over a 15-year period starting in the current fiscal year), nor does it apply to mandated costs for school districts or community colleges, or mandates relating to local government employee relations and benefits. However, the state still has a constitutional requirement to pay these claims.

It should be noted, however, that Proposition 1A does not, and was not intended to, prohibit payment of mandate claims on a current basis. The pay-or-suspend rule focuses on claims already filed because this is a known quantity at the time that the budget is passed, while claims for the budget year can only be estimated.

Budget Proposal Departs from Recent Policy. After several years of deferring most mandate payments due to the state's fiscal problems, the 2005-06 Budget appropriated a total of $241 million for mandate payments to local governments. This amount included funding for both the 2004-05 mandate cost claims (which were required to be paid in the 2005-06 budget to comply with Proposition 1A and avoid suspension of those mandates) *and* for payment of 2005-06 cost claims. Although Proposition 1A's "pay-or-suspend" rule did not require the payment of 2005-06 claims until 2006-07, the Legislature and the administration made a policy choice to provide more timely payments to local governments, consistent with existing law, and to more fully recognize the costs of mandated programs in the state budget.

The 2006-07 Budget continued this policy. It provided $90.3 million to pay remaining 2005-06 claims for unsuspended mandates as required by Proposition 1A, and it also provided $109 million to pay the estimated costs of these mandates in 2006-07. Furthermore, the 2006-07 Budget also included $32 million to pay 2005-06 and 2006-07 claims for the Peace Officers' Procedural Bill of Rights (POBOR) mandate, an employee-relations mandate not subject to Proposition 1A.

LAO Recommends Either Funding 2007-08 Claims or Changes to Existing Law

The 2007-08 Governor's budget proposes a revised policy in which the state would only pay claims for General Fund mandates subject to Proposition 1A and POBOR in the subsequent year. This would not violate Proposition 1A's pay-or-suspend rule. However, it would not be consistent with the claiming process laid out in current law.

Under existing Government Code provisions, local governments (and schools) may file estimated mandate reimbursement claims for the current year with the State Controller's Office (SCO) by January 15th each year. These claims also include revisions to adjust prior-year estimates to actual costs. Alternatively, local governments and schools may choose to file only claims for actual costs, rather than estimates. Statutorily, these claims are intended to be paid promptly and they begin to accrue interest after 60 days. Under the budget proposal, the state would incur interest costs on the deferred claims and local governments would have to "float" these costs until they receive payment.

Audit Deadline Would Also Be Extended. The SCO generally may initiate an audit up to three years after payment is made to a claimant for a specific mandate and a specific fiscal year. Audits must be completed within two years. Consequently, claims are open to audit adjustment for up to five years after a payment is made. By deferring payment for a year, the budget proposal would have the effect of extending the audit deadline, in addition to the payment date, by a year.

COMMENTS

LAO Recommendation. The LAO recommends that the Department of Finance either propose funding for 2007-08 mandate claims (about $150 million for local governments and $185 million for K-14 Education) or propose statutory changes to the Government Code to be consistent with a delayed payment schedule.

Deferral May Make Fiscal Oversight Less Timely and Less Likely. One approach to revising the current statutory framework would be to eliminate the filing of estimated claims and, instead, require all claims to be filed on an actual basis by January 15 of the subsequent year. This would have the advantage of greater accuracy, but the Legislature would have less timely information on cost trends. The other problem with deferral, as the LAO points out, is that it provides less incentive for the Legislature to take actions to control mandate costs, since those actions would not have result in any immediate budget savings.

ISSUE 2: POTENTIAL FUNDING NEEDED FOR PAST MANDATE COSTS

Newly-Identified Mandates

The budget does not include any funding for the following newly-determined mandates, for which the commission has provided the Legislature with statewide cost estimates:

1. Crime Victim's Domestic Violence Incident Reports ($919,000)
2. Peace Officer Personnel Records: Unfounded Complaints and Discovery ($1.8 million)
3. Integrated Waste Management for Community Colleges ($10.8 million, Proposition 98).

No Funding in Budget for New Mandates. The first two of the mandates listed above are subject to Proposition 1A, so they must be funded or suspended. The Integrated Waste Management Mandate for Community Colleges (which is under the jurisdiction of Subcommittee 2) is not subject to Proposition 1A. Furthermore, the commission's finding for that mandate currently is being challenged in a lawsuit by the Department of Finance and the Integrated Waste Management Board. The department and the board point out that the mandated activities produce large amounts of offsetting revenues and savings that the colleges have retained, but which the commission did not consider in its finding or estimate.

Potential Shortfall in AB 3632 Funding

The LAO estimates that counties will file mandate claims totaling $40 million for AB 3632 costs in excess of the categorical and special education funding provided in the current year. These costs would have to be funded in the 2007-08 Budget in order to comply with Proposition 1A. In addition, LAO estimates that county excess AB 3632 costs for services provided in 2007-08 will total $90 million.

Some Current-Year Savings May Be Available

The Department of Finance indicates that some of the mandate funding provided in the current year may remain unspent and available to cover a portion of the costs identified above. The SCO is finalizing its tally of mandate claims and so the actual amount should be known soon.

COMMENTS

The Department of Finance should inform the Subcommittee regarding the following:

1. Whether it proposes to fund, defer, repeal, or take other actions concerning the newly-identified mandates.

2. The magnitude of the potential AB 3632 funding shortfall and how the administration proposes to deal with it.

3. The potential amount of current-year savings that could be used to offset the costs above.

ISSUE 3: MANDATE PROCESS REFORM

A Dysfunctional Process

The current mandate process takes too long and is overly legalistic. "Test claims" filed by local governments (alleging the existence of a mandate) typically take over five years to be resolved by the Commission on State Mandates. During this time, state fiscal liabilities mount and local governments carry out mandates without reimbursement. The claiming guidelines that result from this lengthy process attempt to be precise, but that precision often results in complex rules. This is because few mandates constitute distinct programs; rather they usually add some additional task or requirement to an existing activity. Furthermore, the cost of the additional task or requirement may be reimbursable only in certain circumstances. For example, the LAO points out that whether or not the cost of recording and transcribing certain proceedings is reimbursable under the POBOR mandate depends on who turned on their tape recorder first. Local governments and schools devote considerable resources to mandate record keeping, but the SCO disallows about one-third of local government mandate claims because they are inadequately documented or otherwise do not comply with the commission's complex guidelines. Local governments often appeal these claim reductions to the commission, causing further delays in the mandate payments and diverting commission staff from their primary tasks.

The following indicators illustrate some of the problems in the existing process:

- The commission currently has 14 Parameters and Guidelines (Ps&Gs--claiming rules) determinations pending. The *most recent* legislation establishing any of these mandates was enacted in 2003 and some of the mandate legislation dates back to the 1980s.

- Initial statewide cost estimates currently pending at the commission relate to claims initially filed in 2002 or earlier.

- 118 Incorrect Reduction Claims (challenging reductions by the SCO) are pending at the commission.

- Ongoing litigation occurs around many mandate issues.

Seeking a Simpler Approach—"Reasonable Reimbursement Methodology." In an effort to simplify the mandate claiming process and reduce the number of mandate audits, the Legislature enacted Chapter 890, Statutes of 2004 (AB 2856, Laird), with every member of the Assembly Special Committee on State Mandates serving as a coauthor. (The special committee met for over a year and reviewed the mandate process in depth.) Chapter 890 authorized the commission to adopt a "reasonable reimbursement methodology" for mandates, a methodology that places greater emphasis on the use of unit costs and other approximations of local costs, rather than detailed documentation of actual local costs. Unfortunately, although DOF and local agencies have proposed reasonable reimbursement methodologies, the commission has not yet adopted one. A significant obstacle to use of this approach has been the commission's legal interpretation that it must ensure that *actual* local government cost data from *all* potential claimants—a requirement that generally is impossible to meet because some local governments and school districts may not incur costs under a mandate until many years later.

Administration Proposes an Alternative Process

The administration has proposed Budget Trailer Bill Language to create an alternative to the cumbersome, contentious and lengthy current process in which the commission determines mandates and establishes their reimbursement guidelines. In the alternative process, the Department of Finance will work with local agencies to develop a cost-efficient method of compliance with new laws and a reasonable and relatively simple way to determine the amounts to be reimbursed to local governments. This new "joint determination" process would encourage local agencies and the Department of Finance to determine together, within 12 months of the enactment of a new statute, whether a new mandate has been imposed and the cost guidelines for that mandate. Costs, once agreed upon by both parties, would be submitted for Legislative review in the budget bill. If local agencies disagreed with the joint determination, they could opt to follow the current mandate determination process.

LAO Supportive, But Some Improvements Needed

LAO agrees with the administration's general approach, but identifies the following problem areas in the proposal:

- **Diminishes the Legislature's Information and Policy Options Regarding Mandates.** Under current law, the Legislature receives a legal decision and proposed methodology regarding each mandate and may direct the commission to reconsider these documents if it believes the commission did not consider important information. The Legislature also may modify the reimbursement methodology and/or reduce funding for a mandate, as long as its actions do not interfere with local government's constitutional right to reimbursement. Under the administration's proposal, in contrast, the Legislature's role is reduced to reviewing the agreement negotiated between the administration and local governments—and accepting or rejecting it.

- **Does Not Acknowledge the Legal Alternatives Available to Local Governments That Disagree With a Proposed Settlement.** The administration's proposal appears to assume that a mandate settlement, negotiated between DOF and *some* local governments, would be the *sole* basis for mandate reimbursement for *all* local governments. Given that the California Constitution entitles local governments to reimbursement of their mandated costs, LAO thinks it likely that the courts would allow local governments that are not satisfied with the funding provided under this negotiated settlement to file court actions for additional reimbursement.

- **Expedites and Simplifies Too Few Mandates.** The administration indicates that it wishes to focus its efforts on those claims that are subject to the annual mandate payment requirement of Proposition 1A. This measure provided exceptions for mandates affecting educational agencies and pertaining to employee rights. Such an approach greatly reduces the potential effectiveness of the administration's proposal. LAO notes that 55 of the 86 mandate test claims pending before the commission are from educational agencies and five others relate to employee rights, both exempt from Proposition 1A's annual pay-or-suspend requirement. Thus, less than a third of these 86 test claims potentially could be expedited under the administration's proposal.

LAO Proposes a More Extensive Alternative Process

Building on the Governor's proposal, LAO has developed its own reform package to expedite and simplify the mandate determination process without altering local rights or state responsibilities under the Constitution's mandate reimbursement requirement. The LAO proposal appears in the office's publication: *The 2007-08 Budget Perspectives and Issues*. LAO maintains that the variation in local government mandates means that no single change would improve the process for all claims. Accordingly, the LAO reform package includes the following three elements that LAO recommends that the Legislature enact as *optional* alternatives to the existing process:

- **Amend the existing Reasonable Reimbursement Methodology Statute.** Our proposal clarifies the type of easy-to-administer reimbursement methodology that the Legislature envisioned when it enacted this statute. While we would encourage the commission to use this approach to the greatest extent possible, the commission could adopt Ps&Gs using the existing approach (documented actual costs) if it were most appropriate for a specific mandate.

- **Modify the Existing Mandate Process to Allow Reimbursement Methodologies and Estimates of Statewide Costs to Be Developed Through State-local Negotiations, With Minimal Commission Oversight.** This option would replace the existing adversarial process with a single negotiated step, expediting the existing process by at least a year. Because the negotiated Ps&Gs would be based on the reasonable reimbursement methodology approach described above, this negotiated process also simplifies the claiming process.

- **Create an Alternative Mandate Process That Bypasses the Commission Process Entirely.** This alternative would resolve mandate claims in about a year, thus offering the greatest potential for expediting the mandate process. While this alternative probably would be used for only a small number of claims (where there is a wide agreement between local governments and the administration), any reduction in the number of claims would improve the commission's processing time for other claims.

- **Provide Stability While Recognizing Local Government Rights.** Local governments and schools have a constitutional right to adequate reimbursement of mandated costs. Accordingly, the state cannot arbitrarily impose conditions or limitations on payment. Neither can some local government entities bind all others to the same agreement. However, the state cannot be in the position of allowing local governments to choose their reimbursement methodology each year—claiming some standard average amount when their costs are low or nonexistent and seeking full-cost reimbursement when their costs temporarily exceed the standard. In order to avoid these problems, the LAO proposal includes the following features:

  - A requirement that the administration and local government negotiators (1) use information from a wide range of local governments to develop their proposed reimbursement methodologies and (2) assess and verify local support for any methodology before it is proposed to the Legislature. In addition, the Legislature could reject a proposal and request that it be renegotiated to secure a higher level of local acceptance.

  - A prohibition on local governments that object to a proposed settlement from receiving the negotiated reimbursements. Instead, these local governments must file a test claim with the commission and proceed through the regular mandate determination process.

  - A requirement that local governments that accept negotiated funding must remain under this reimbursement system and not file a test claim related to the mandate for five years. (This restriction would not apply, however, if the Legislature changed the reimbursement methodology or the funding amount so as to reduce the funding to which the local government was entitled.)

  - A provision that if a court or the commission later finds that the state's reimbursement amounts were not sufficient, any state funding provided to local agencies pursuant to the alternative dispute resolution process counts as an offset to the state's overall liability.

Commission Staff Recommendation

At the direction of the commission, the Commission on State Mandates staff has analyzed both the administration and LAO mandate reform proposals. The staff has recommended a number of revisions to the LAO proposal to take account of some procedures now available in existing law and to provide a more developed legal and operational foundation for "legislatively determined mandates" in order to ensure coordination with the commission processes.

COMMENTS

The administration, LAO, and the commission should present their proposals to the Subcommittee and note significant areas of agreement and difference.

Related Legislation. AB 1576 (Silva) incorporates the LAO proposal. AB 1222 (Laird) makes a technical change to test claim requirements, but also could serve as a vehicle for mandate reform. AB 1170 (Krekorian) would automatically approve mandate test claims if the commission did not act on them within 24 months.