

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

**PART II**

**Assemblymember Rudy Bermudez, Chair**

**TUESDAY, MAY 23, 2006, 1:30 PM**  
**STATE CAPITOL, ROOM 437**

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## ITEMS TO BE HEARD

### **ITEM 1900 CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM**

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The California Public Employees' Retirement System (CalPERS) administers retirement and health benefits for more than 1.4 million active employees and retirees of state and local agencies in California. Benefits include retirement, disability, and survivor's retirement benefits, Social Security for State employees, and the development, negotiation, and administration of contracts with health maintenance organizations, group hospitals, and medical insurance plans. In addition, CalPERS administers a long-term care program for members and eligible individuals.

CalPERS is governed by a Board of Administration. The California Constitution provides that the Board of Administration has authority over the administration of the retirement system. Therefore, the budget data presented here is for informational purposes only, with the exception of the component of the Health Benefits Program funded from the Public Employees' Contingency Reserve Fund.

The Governor's budget allocates \$1.3 billion from the General Fund and Special Fund contributions totaling \$745,000. The Governor's budget proposes total expenditures of \$12.3 billion with funding coming primarily from the Public Employees' Retirement Fund and the Public Employees' Health Care Fund.

#### **ISSUE 1: DIVERSITY OF INVESTMENT**

On June 15<sup>th</sup>, 2004 CalPERS submitted to the legislature a Commitment to Diversity Report. This report discussed CalPERS existing diversity programs and participation rate levels in CalPERS business activities by ethnic minority firms, women-owned firms, and ethnic minority and women employees, focusing on the management of CalPERS investment assets.

#### **COMMENTS**

At the request of the chair, this is an informational issue for CalPERS staff to update the committee on CalPERS status and progress since the 2004 report.

**ITEM 1920 CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM**

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The State Teachers' Retirement System (STRS) provides retirement related benefits and services to 735,000 active and retired educators in public schools from kindergarten through the community college level. The system provides three types of benefits: 1) service retirement benefits determined on the basis of member's age, years of service, and final compensation 2) survivor benefits and 3) disability benefits.

The STRS board has twelve members; four ex-officio members including the Superintendent of Public Instruction, State Treasurer, State Controller, and the Director of Finance; three public members; one retiree of STRS; one member that is either a school board member or community college trustee; and three representatives elected by STRS members.

The main objectives of STRS include: the maintenance of a financially sound retirement system, the maintenance of efficient administrative operations, continuous improvement of the delivery of benefits products and services to STRS members, and the development and improvement of the benefits and products to STRS members.

**ISSUE 1: DIVERSITY OF INVESTMENT**

At the request of the chair, this is a follow up based on the information provided to the committee on May 3, 2006.

**ISSUE 2: REVISED BUDGET**

It is requested that Item 1920-011-0001 be decreased by \$119,516,000 to reflect an error recently discovered in the California State Teachers' Retirement System (CalSTRS) accounting system. The error resulted in the state underpaying the Benefits Funding and Supplemental Benefit Maintenance Account in fiscal years 2003-04 through 2005-06. The error also led to the state overpaying the CalSTRS 1990 Benefits Funding in fiscal years 2004-05 and 2005-06. These General Fund transfers have already been completed; therefore the corrections, which result in a net overpayment to CalSTRS, are included as an adjustment to the state's 2006-07 transfer from the General Fund.

It is requested that Item 1920-011-0001 be decreased by \$1,975,000 to reflect CalSTRS revised estimate of teacher compensation. The state contributes a total of 4.517 percent of teacher compensation to CalSTRS. This revised estimate of teacher compensation results in a reduction to the state's 2006-07 contribution.

Trailer bill language to effect the above adjustments is also part of this request.

Section 1. (a) It is the intent of the Legislature to provide for a means of rectifying errors made in calculating the state's contributions to the State Teachers' Retirement System during fiscal years 2002-03, 2003-04, 2004-05, and 2005-06, which have been identified to the board by its actuary. The following accounting adjustments shall be made notwithstanding any other provision of law, including without limitation, Education Code 22954 and Education Code 22955. This statute shall become inoperative on June 30, 2007.

(b) Notwithstanding the board's creditable compensation calculation of October 1, 2005, for the 2006-2007 fiscal year only the State Controller shall account the continuous appropriation of Education Code 22955(a) to be the amount based on the board's creditable compensation calculation of March 2006, which is less than an appropriation based on the board's creditable compensation calculation of October 1, 2005 in the amount of one million, three hundred seventy-seven thousand, eight hundred and seventy dollars (\$1,377,870).

(c) Notwithstanding the board's creditable compensation calculation of October 1, 2005, for the 2006-07 fiscal year only the State Controller shall account the continuous appropriation of Education Code 22954(b) to be the amount based on the board's creditable compensation calculation of March 2006, which is less than an appropriation based on the board's creditable compensation calculation of October 1, 2005 in the amount of one million, seven hundred six thousand, six hundred eighteen dollars (\$1,706,618).

(d) The State Controller shall account the amount appropriated pursuant to Education Code 22955(a) in fiscal year 2004-05 that is in excess of the amount required, which has been determined by the board to be eight hundred and eighty-one thousand, seven hundred and twenty-three dollars (\$881,723), as an advance of the appropriation pursuant to Education Code 22955(a) for fiscal year 2006-07.

(e) The State Controller shall account the amount appropriated pursuant to Education Code 22954(b) in fiscal year 2004-05 that is in excess of the amount required, which has been determined by the board to be one million, ninety-two thousand, eight hundred and sixty-five dollars (\$1,092,865) as an advance of the appropriation pursuant to Education Code 22954(b) for fiscal year 2006-07.

(f) The State Controller shall account the amounts appropriated pursuant to Education Code 22955(b) in fiscal years 2002-03 through 2005-06 that are in excess of the amounts required, the cumulative amount of which has been determined by the board to be one hundred twenty-two million, six hundred thousand, two hundred thirteen dollars (\$122,600, 213), as an advance of the appropriation pursuant to Education Code 22955(b) for fiscal year 2006-07.

Section 2. The net effect of these accounting adjustments shall be that the State Controller has already paid from the General Fund to the State Teachers' Retirement Fund Defined Benefit Program the amount of one hundred twenty-two million, one hundred four thousand, sixty-six dollars (\$122,104,066) of the amount that would otherwise be transferred by the State Controller on July 1, 2006; and the State Controller will transfer an additional six hundred thirteen thousand, seven hundred fifty three dollars (\$613,753) more than the amount that would otherwise have been transferred from the General Fund to the Supplemental Benefit Maintenance Account in the State Teachers' Retirement System on July 1, 2006.

<b>COMMENTS</b>
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This is correcting an error from previous years, and changing State Contributions to conform to revised estimates.

**ITEM 8260 CALIFORNIA ARTS COUNCIL****ISSUE 1: EXTENSION OF LIQUIDATION PERIOD**

The Italian Cultural Society of Sacramento was originally allocated funding for the Italian Cultural Museum in 2000-2001 in the amount of \$300,000 for "the purpose of assisting with expenditures associated with the capitol outlay expenditures for the purchase of land to be used solely for the development and construction of an Italian American Museum and Cultural Center." The Italian Cultural Society provided adequate documentation and funds were remitted to them. All but \$7,295.55 was allocated of that funding.

In 2001-2002, another \$500,000 was allocated to the Italian Cultural Society of Sacramento. The Legislature directed the Arts Council to issue all awards quickly without delay, including the Italian Culture Society award.

Because of this, the funding was given to the Italian Cultural Society, but no documentation or reporting has since been required.

The Italian Cultural Society claims that "the money is being placed in escrow now to cover the cost of acquisition of the project property. They have a contract with the developer to purchase a building in the development. The building is now under construction. However, the building will not be completed for a few months, at which time the escrow closes and the project is complete."

Because the project will not be completed, and thus escrow will not close until after June 30<sup>th</sup>, 2006, the project requires an extension to allow the construction to finish.

**COMMENTS**

It is possible that because the funding is already in escrow, this extension is not necessary, but it is not clear. As such, the department has asked for this extension to be safe. This funding has already been given by the state, so there is no additional cost to the General Fund.

Because of the circumstances surrounding the disbursement of these funds the and several years without following it, the committee may wish to adopt language similar to below if extending the liquidation period for the funds.

8260-490—Reappropriation, California Arts Council. The balance of the appropriation provided in the following citation is reappropriated for the purpose of assisting with expenditures associated with the capital outlay, property acquisition, development, and construction of an Italian American Museum and Cultural Center, as sponsored by the Italian Cultural Society, and shall be available for encumbrances or expenditure until June 30, 2007.

001—General Fund

(1) \$500,000 in Item 8260-105-0001, Budget Act of 2001 (Ch. 106, Stats. 2001).

Provisions:

1. By September 1, 2006, the Italian Cultural Society shall provide to the Department of Finance documentation of the amount and purpose of funds encumbered prior to June 30, 2006 for the capital outlay, development, and construction of an Italian American Museum and Cultural Center, the amount remaining, and the expenditure plan for the remaining funds.

This budget language may not be necessary if, by placing the funding in escrow, these funds are already considered encumbered. Department of Finance is currently looking into this.

**ITEM 9800 AUGMENTATION FOR EMPLOYEE COMPENSATION**

This budget includes funding for state civil service and related employee compensation for changes in the cost of new agreements with employee bargaining units and other costs that do not fit in an individual department's budget. Employee compensation funding is based upon approved Memoranda of Understanding for represented employees that are ratified by the Legislature. Compensation for excluded employees is determined by the Department of Personnel Administration or other authorized entities.

The Governor's May Revise proposes an increase of General Fund expenditures of \$80 million and \$7.8 million special fund.

**ISSUE 1: PLATA LAWSUIT**

In April 2001, the Prison Law Office filed a class action lawsuit titled *Plata v. Davis* challenging the State's ability to provide adequate medical care to prison inmates.

Compliance with the terms and conditions of the settlement agreement is dependent upon the phased implementation of the Inmate Medical Services Program Policies by the Department of Corrections and Rehabilitation to meet the minimum level of care necessary to fulfill the department's obligation. The benefits of the proposed changes include: more timely and comprehensive assessment of inmate needs as they enter CDC; improved access to medical services; the implementation of a comprehensive chronic care program using standardized data collection forms and guidelines consistent with National Commission on Correctional Health Care panels where at each visit, an assessment will be made on how well the inmate is doing as compared with established standards; staffing of emergency rooms by registered nurses 24 hours a day, seven days a week and a 30 day follow-up assessment by the primary care physician whenever a referral of an inmate to a specialist has been made.

The Administration requested funding of \$67 million (\$56 million General Fund) in the January 10 Governors' Budget to increase the pay of State-employed doctors and nurses in accordance with the court order to immediately increase compensation for several classes of prison medical personnel.

The May Revise requests an increase to that amount of \$25,164,000 for costs related to the *Plata v. Schwarzenegger* lawsuit. Part of this increase is to offset the May Revise removal of \$10.74 million in special funds previously budgeted for Plata.



The new estimates provided are:

CDCR (Adult): \$43.38 million

CDCR (Youth): 2.45 million

DMH: \$36.56 million (plus .34 million special fund)

Total: \$82.38 million General fund and .34 million special fund

#### LAO

Court-ordered pay increases for personnel in a single department, such as CDCR, likely will produce higher salary costs for similar personnel throughout state government. The LAO, however, continues to be concerned that the administration's handling of pay raises resulting from *Plata* will inflate public employee salaries beyond what is required to meet court mandates. In addition, given subcommittee testimony that medical personnel in other departments face staffing shortages similar to those of CDCR and DMH, a question for the Legislature is what technique should be used to choose medical and similar personnel, if any, that will receive compensation 1) not required by the court orders and 2) outside of the collective bargaining process.

In testimony before Senate Budget and Fiscal Review Subcommittee No. 4 on May 17, 2006, the Department of Personnel Administration stated that all of the compensation increases budgeted in the May Revision for CDCR were "required" by the *Plata* court order, although these costs are more than double the approximately \$21 million of annual funding estimated by the administration to be needed as of December 2005. Funds budgeted in the May Revision for DMH salary increases match closely those of which the Legislature already has been informed.

#### COMMENTS

The questions raised by the LAO are valid concerns in making sure that the committee does not over extend the effects of the court order and begin to infringe on the collective bargaining process. LAO points out that the costs for DMH seem in line with previous estimates, though the CDCR costs have doubled from initial estimates.

**ITEM 8660 PUBLIC UTILITIES COMMISSION****ISSUE 1: RAIL SECURITY LACKING**

Recent investigative reporting has uncovered a dangerous lack of railroad security. Reporters found that there was not even a fence line to keep people out of the Union Pacific's Roseville railyard, the largest west of the Mississippi River. Reporters noted tankers loaded with hazardous materials that sat unsecured for hours at a time. The only signs of security were "no trespassing" signs. There was no sign of a single guard. A maintenance worker assigned to the yard said security is a joke and that the railroad is turning its back on homeland security.

The lack of security poses a serious threat to public safety. Studies by Sacramento area governments suggest that if a 90-ton tanker of chlorine exploded in a heavily populated area, as many as 100,000 people would die in less than 30 minutes.

**COMMENTS**

The Public Utilities Commission (PUC) is the state agency responsible for rail safety.

The PUC should address the following issues:

- What authority and/or jurisdiction does it have over rail security?
- What does the commission do to enforce rail security?
- Do the conditions observed at the Roseville yard comply with existing laws and regulations? Is this lack of security endemic throughout California?
- What is an acceptable level of security in the view of the PUC?
- What actions does the PUC plan to take to improve security at Roseville and all other rail facilities in the state?

## **CONTROL SECTION 3.45 STATEWIDE REDUCTION TO SALARIES AND WAGES**

The Governor's Budget includes Control Section 3.45, which requires the Director of Finance to reduce General Fund appropriations by a total of \$58 million, based on a one-percent reduction in salaries and wages spending.

### **ISSUE 1: MAY REVISION EXEMPTS CORRECTIONS**

The May Revision requests a revision of the language in Control Section 3.45 to exempt the California Department of Corrections and Rehabilitation (CDCR) from the reduction. This revision would reduce savings by \$36.5 million (from \$58 million to \$21.5 million).

The administration states that applying the reduction to CDCR would be inconsistent with the administration's proposal to augment CDCR by \$52.8 million to expand inmate and parolee programs, and that it cannot reduce court-mandated programs, such as healthcare.

### **COMMENTS**

While CDCR may have a good argument for exemption from the one-percent salaries and wages cut, other departments also have compelling cases for exemption. For example, approximately \$4 million of the remaining \$21.5 million of cuts would come from the state's two major tax agencies—the Franchise Tax Board and the State Board of Equalization.

**Suggested Options.** Across-the-board-cuts, such as that imposed by Control Section 3.45 undermine good budgeting. Staff suggests two options:

1. Delete Control Section 3.45 entirely. This would increase spending by \$21.5 million above the May Revision.
2. Approve the May Revision request, but include the two tax agencies in the exemption. This would increase budgeted spending by about \$4 million over the May Revision, but may also prevent a larger revenue loss.

**CONTROL SECTION 35.60      BUDGET STABILIZATION ACCOUNT TRANSFER  
AUTHORITY**

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

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

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

**May Revision Estimates.** The May Revision estimates that \$944 million will be transferred to the BSA in 2006-07, of which half would go towards repayment of the ERBs and the remainder (\$472 million) would remain in the BSA. In addition, the May Revision projects a General Fund reserve of \$1.7 billion. The Governor does not propose to suspend the 2006-07 transfer to the BSA.

**ISSUE 1: TRANSFER AUTHORITY**

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

**COMMENTS**

**Cake and Eat It Too.** The administration is trying to have it both ways. If the Governor feels it necessary to have a larger reserve in the General Fund itself, then he could suspend the BSA transfer. However, he does not propose to do so. Instead, the administration is asking for this language, which would effectively make the BSA part of the regular General Fund reserve from the administration's point of view. The result would be honoring the letter of Proposition 58, but not its intent.

**Bypasses Legislature.** If General Fund revenues fall short during the year, the proposed control section would enable the administration to use BSA funds to maintain its spending priorities without Legislative approval. This is contrary to the intent of Proposition 58. Instead, any use of the BSA should require enactment of legislation. Eliminating Control Section 35.60 would accomplish this.