

AGENDA
ASSEMBLY BUDGET SUBCOMMITTEE NO. 4
ON STATE ADMINISTRATION

Part III

Assemblymember Rudy Bermudez, Chair

Wednesday, May 18, 2005, 1:00 pm
State Capitol, Room 447

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ITEMS ON CONSENT

ITEM 0860 STATE BOARD OF EQUALIZATION

1. **May Revision Special Tax Jurisdiction Workload Increase**

Augmentation of \$2.262 million (reimbursements from local tax revenues) to add 27.7 positions due to workload from 24 new Special Tax Jurisdictions approved in 2004 elections.

2. **Revised Estimate for Administration of eWaste Recycling Fee**

The board has revised its cost estimate for this new legislatively mandated program downward for a reduction of \$716,000 (special fund).

ITEM 1730 FRANCHISE TAX BOARD

May Revision Requests

1. **Phase III Occupancy Cost Adjustment**—It is requested that Item 1730-001-0001 be decreased by \$3,759,000 to reflect a revised estimate of the moving costs associated with occupying the Franchise Tax Board's (Board) Phase III Office Complex. This reduction partially offsets an April Finance Letter request for an augmentation of \$7,130,000, so that the net change to the Governor's Budget is an augmentation of \$3,371,000 from the General Fund (plus small amounts from various special funds). This action encompasses both the April and May Finance Letter requests.
2. **Phase III Office Complex Debt-Service Payments**—It is requested that Item 1730-001-0001 be increased by \$1,927,000 (General Fund) to account for debt-service payments the Board will make to the Department of General Services for the bonds that were issued to pay for construction of the Phase III Office Complex.
3. **California Child Support Automation System (CCSAS) Carryover Adjustment**—It is requested that Item 1730-001-0001 be augmented by a net of \$673,000 (\$1.8 million increase in federal reimbursements less \$1.2 million General Fund savings) for CCSAS related activities. The requested adjustment consists of the following elements:
 - A reduction of \$1,158,000 General Fund to reflect the availability of this amount of carryover funding from 2004-05. The availability of this carryover amount is primarily attributable to project savings.
 - An increase of \$1,831,000 in reimbursement authority to reflect the shift of federal funding provided by the Department of Child Support Services from 2004-05 due to delay of current-year project deliverables to a minor extent. The administration notes that these delays will have no impact on the overall project timeline.
4. **Lease Revenue Payment Adjustments.** Adjustment per Control Section 4.30—It is requested that Item 1730-002-0001 be decreased by \$99,000 (General Fund) and reimbursements be decreased by \$35,000 to reflect Control Section 4.30 adjustments made in the fall. Additional Lease Revenue Payment Adjustment – It is requested that Item 1730-002-0001 be decreased by \$30,000 (General Fund) and Reimbursement be increased by \$30,000 for lease revenue payments.

ITEMS TO BE HEARD

ITEM 1730 FRANCHISE TAX BOARD

ISSUE 1: INDEPENDENT CONTRACTOR TAX COMPLIANCE

At its April 19th hearing, the subcommittee directed the FTB and LAO to report back with a proposal to develop more specific information and approaches to measure compliance by independent contractors and to explore approaches to obtain better information reporting and potential categories of independent contractors with compliance problems for whom withholding might be a feasible and practical approach.

In response, LAO and the FTB propose the following Supplemental Report Language:

The Franchise Tax Board, in consultation with the Employment Development Department and the Legislative Analyst's Office, shall provide to the Chair of the Joint Legislative Budget Committee and the chairs of the fiscal committees of both houses of the Legislature, an addendum to the report prepared pursuant to the Supplemental Report of the 2004 Budget Act related to withholding on payments to independent contractors. The addendum shall include, but not be limited to, analysis regarding: (1) tax compliance rates for independent contractors associated with business segments for which withholding is most practicable; (2) estimated revenues due to compliance and acceleration from implementing a withholding program for such business segments; (3) technical and administrative capabilities to implement a withholding program for such business segments; (4) impacts on businesses and independent contractors; (5) growth trends for business segments relating to usage of independent contractors versus employees; (6) recommendations for more effectively matching information return data against data reported on individual and business entity income tax returns to improve compliance. The report update is to be submitted December 1, 2005.

In addition, the FTB requests adoption of Budget Bill Language to allow it to obtain a limited amount of expert and consultant assistance for the independent contractor tax compliance effort:

Of the amount available for Franchise Tax Board to conduct tax gap and discovery activities, the Board may redirect up to \$200,000 for the purpose of engaging experts and consultants to: quantify tax compliance by independent contractors; identify and evaluate independent contractor withholding alternatives; determine the impact of such alternatives on state revenues; determine technical and administrative capabilities to implement a withholding program as well as the impacts to business and industry; and evaluate potential solutions to implement a withholding program.

ISSUE 2: COORDINATION AND IMPROVEMENT OF CALIFORNIA'S TAX INFORMATION SYSTEMS

At its April 19th hearing, the subcommittee discussed the need for, and potential benefits of, an integrated and modernized tax information system for the state. FTB has a number of information systems that are used for specific purposes, such as the compilation of tax data and audit selection. The Board of Equalization (BOE) and the Employment Development Department (EDD) also maintain their own data systems. Other potentially useful sources of data for tax compliance purposes reside in information systems within other agencies, such as professional licensing, driver's licenses, and corporate registrations—and at the local level with county assessors, for example.

An integrated data system with a universal taxpayer identifier would improve compliance and enforcement capability for all of the tax agencies. However, development of a comprehensive single information system would be a massive, expensive, and risky project. A more practical approach would recognize that each of the tax agencies is continually in the process of upgrading and replacing various elements of its information systems. Coordination of these efforts, along with selected system enhancements and additions could offer significant opportunities to improve tax administration and compliance and reduce in order to reduce the "tax gap" between what is owed and what is actually collected under the state's tax structure.

COMMENTS

Adoption of the following Supplemental Report Language would begin the process of identifying current tax information system capabilities, system gaps, opportunities for better coordination and improvement, and of building an ongoing coordinating structure:

The Legislative Analyst's Office (LAO) and the Department of Finance (DOF) shall jointly report to the Legislature by March 1, 2006 on the state's existing tax information systems and the potential for improvements and coordination to make them more effective and useful. The LAO and DOF shall convene a working group consisting of staff of the Franchise Tax Board, State Board of Equalization, Employment Development Department, and State Chief Information Officer to provide information, expertise, and assistance in the development of the report. The report shall focus on information and data systems for the Personal Income Tax, the Corporation Tax, the Sales and Use Tax, and payroll taxes. The report shall include the following information:

- 1) An inventory of existing major tax information and data systems at the participating agencies and of information technology projects or significant improvements currently in development. The report shall identify for each system, the following information:
 - a) The purpose and major uses of the system.
 - b) Categories of taxpayers and types of taxes addressed by the system.
 - c) Types and sources of information or data collected and the frequency of collection.
 - d) Significant linkages with other tax information or data systems, including federal and local.
 - e) System architecture, the potential for information exchange with other systems, and the flexibility of the software or database structure.

- 2) On a preliminary basis, the report shall identify opportunities and provide any recommendations regarding the following items:
 - a) Providing common taxpayer identification across information systems.
 - b) Linking systems and sharing information to improve revenue collection and/or reduce tax administration costs.
 - c) New information systems or system enhancements that would significantly improve revenue collection and/or reduce tax administration costs.
- 3) The report also shall present recommendations or options for an ongoing management and coordination structure for the state's tax information and data systems.

ITEM 9210 LOCAL GOVERNMENT FINANCING

ISSUE 1: MAY REVISION--PROPERTY TAX ADMINISTRATION GRANT PROGRAM

At its April 26th hearing, the subcommittee augmented this item by \$5.7 million to restore full funding of \$60 million for the Property Tax Administration Grant Program (PTAP). These grants provide additional funding to assist county assessors to process reassessments of property due to sales or new construction, resulting in additional property tax revenue for local governments and K-14 Education (offsetting the state's Proposition 98 funding requirement). A key component of the program is a maintenance-of-effort requirement for counties to keep assessors funding and staffing at least at the 1994-95 level to be eligible to receive PTAP funds. The Governor's Budget assumed that there would be no reduction in property tax revenues (resulting in an increase in state school funding) due to the reduction in the grant program. Material submitted by local agencies suggested, however, that state savings would be more than offset by a loss of property tax revenue to K-14 education and resulting higher General Fund costs. The Los Angeles County assessor, for example indicated the program yields \$6.50 for schools for every \$1 in PTAP funding.

The May Revision Proposes Partial Restoration of Funding

The May Revision requests a net restoration of \$2,474,000 (\$3,192,000 less than the full restoration of \$5,666,000 adopted by the subcommittee). The Department of Finance (DOF) attributes the remaining \$3.2 million of savings to (1) elimination of grant funds for Marin and San Mateo Counties (\$3 million) and (2) the elimination of grant funds for five small counties that have never applied for funds (\$0.2 million).

DOF argues that all the school districts and community college districts in Marin and San Mateo counties receive sufficient property taxes to fully fund their basic apportionments, and therefore the property tax revenues they would generate with Grant monies would not offset the state's Proposition 98 General Fund obligation.

COMMENTS

Although most of the K-14 districts in Marin and San Mateo counties are "basic aid" districts, not all are, according to staff of the Department of Education. Moreover, other counties also have high proportions of basic aid districts. Thus, it would not be equitable to single out the two counties for complete elimination of their PTAP grants. Instead, the subcommittee may wish to adopt the May Revision savings and add the following Budget Bill Language in Item 9210-105-0001:

The Department of Finance shall reduce the grant amounts specified in Section 95.35 of the Revenue and Taxation Code to be consistent with the total amount of funds appropriated by this item. These reductions shall take into account the potential state benefit from increased property tax revenues in each county, provided that no qualified applicant county shall receive less than half of the amount specified in Section 95.35 of the Revenue and Taxation Code.

This language would provide direction to DOF to allocate the reduction more broadly and it would maintain at least half of each county's funding to mitigate disruption to the assessment program of any individual county.

ISSUE 2: OPEN MEETINGS ACT MANDATE

At its April 26th hearing, the subcommittee held this item open.

The Governor's Budget proposes to restructure the Open Meetings mandate and provide \$2 million in 2005-06 funding, a funding level significantly below the \$15 million expense expected in the current year (after all claims eventually have been filed). The Department of Finance (DOF) has proposed a statutory change to allow local agencies to post their full agenda as an option to preparing brief summaries of each agenda item, as currently required.

Proposition 1A Funding Requirement. Under Proposition 1A, the state must provide funding for 2004-05 reimbursement claim amounts (determined as of when the budget is passed) if a mandate is not to be suspended or repealed (or made optional). Claims for 2004-05 costs for this mandate filed with the Controller total \$11.5 million. Consequently, to keep the mandate in force and meet the requirement of Proposition 1A requires an augmentation of \$9.5 million. Proposition 1A does not require funding of budget-year costs in order to avoid suspension or repeal.

LAO Suggests Making Mandate Optional: In 1953, the Legislature enacted the Brown Act, declaring, "all meetings of the legislative body of a local agency shall be open and public, and all persons shall be permitted to attend any meeting of the legislative body." Because the Brown Act preceded the 1975 operative date of mandate law, its requirements are *not* a state-reimbursable mandate. Instead, the Open Meeting Act "mandate" pertains to certain post-1975 procedural amendments to the Brown Act, most notably the requirement that local agencies prepare and post agendas 72 hours before a hearing (Chapter 641, Statutes of 1986 [AB 2674, Connelly]).

COMMENTS

LAO points out that Californians have shown longstanding interest in open hearings, and the state's voters recently enacted Proposition 59, amending the State Constitution to specify that meetings of public bodies and writings of public officials must be open to public scrutiny. However, effective public participation in, and press scrutiny of, government actions requires some advance notice of proposed actions or topics of discussion, as provided by this mandate.

The DOF has made a proposal for reducing future costs of this mandate, which should receive further opportunity for review to determine how well it would protect public participation and access and how much it would save.

Accordingly, the subcommittee may wish to (1) augment this item by \$9.5 million to comply with Proposition 1A and avoid suspension and (2) adopt placeholder trailer bill language to reduce the cost of the mandate so that this issue can be explored further during Conference.

ISSUE 3: PHOTOGRAPHIC RECORDS OF EVIDENCE MANDATE

The subcommittee heard this issue at its April 26th hearing and held it open. The Governor's Budget proposes suspension of this mandate. This mandate requires local law enforcement agencies to provide photographs, chemical analyses, and other substitutes for evidence that a court determines poses a health, safety, security, or storage problem. In their mandate claims, local agencies typically request reimbursement for purchases of high-tech digital imaging and printing equipment.

COMMENTS

The LAO has pointed out that suspension adds ambiguity to the laws of evidence and may increase court costs. The Judicial Council states that suspension of this mandate would impose additional costs on the courts to handle hazardous, toxic, or otherwise unsafe exhibit items. These costs would be a state responsibility

Based on the information presented above, the subcommittee may wish to maintain the mandate by funding 2004-05 claims (\$300,000).

ISSUE 4: MANDATE REIMBURSEMENT PROCESS MANDATE

The subcommittee heard this issue at its April 26th hearing and held it open.

This mandate reimburses local agencies for their administrative costs to file mandate test claims and reimbursement claims. The reimbursement claims for this mandate totaled \$17 million in 2002-03, of which \$6.7 million was from local governments and the remainder from schools and community colleges. Most of the local government costs are for submitting ongoing mandate claims (as opposed to initial test claims). Typically, local agencies request reimbursement for their costs to (1) contract with mandate consulting firms and (2) oversee their consultants' contracts. The administration proposes to suspend this mandate in 2005-06. As a result, local agencies would not be required to follow the existing statutory mandate reimbursement process.

COMMENTS

Suspension of the mandate process provisions is highly problematic because it would create a chaotic situation in which there might be no rules for mandate claims. Instead, the subcommittee discussed the approach of adopting Trailer Bill Language directing the Commission on State Mandates to reconsider its original finding that compliance with the mandate reimbursement process is itself a reimbursable mandate. The decision to seek reimbursement clearly is discretionary on the part of local governments. While local governments have a right to reasonable reimbursement of valid mandated costs, there is not necessarily any right to payment for submitting the claims. Another approach would be to establish stricter parameters and guidelines for these costs.

Unless and until the Commission on State Mandates reconsiders these provisions and determines that they are not a mandate, funding should be provided to maintain the requirements of the mandate reimbursement process, consistent with the provisions of Proposition 1A. According to the State Controller's Office, the amount of claims filed for 2004-05 is \$4.3 million at present. Appropriating this amount will retain the mandate claims process in 2005-06.

The subcommittee may also wish to adopt placeholder Trailer Bill Language (1) directing the commission to reconsider whether this claims process actually is a reimbursable mandate and (2) setting tighter criteria for reimbursable costs in order to place this issue in conference.

ITEM 0110, 0120, 0130 LEGISLATURE

ISSUE 1: UPDATED BUDGET FOR SENATE, ASSEMBLY, AND LAO

The Legislature's budget is adjusted every year in accordance with the State Appropriations Limit (SAL). The following amendments should be made in accordance with the adjustments to the SAL identified in the May Revision.

- 0110 Senate – Adopt technical adjustment to increase schedule (4) by \$1,041,000.
- 0120 Assembly – Adopt technical adjustment to increase schedule (4) by \$1,412,000.
- 0130 LAO – Adopt technical adjustment to increase schedule (1) by \$220,000, decrease schedules (2) and (3) b \$35,000, and add schedule (4) at -\$150,000.

ITEM 0160 LEGISLATIVE COUNSEL BUREAU**ISSUE 1: ENTERPRISE STRATEGIC INITIATIVE**

The Legislative Counsel requests \$1 million (General Fund) for development of an Enterprise Strategic Initiative (ESI) project to replace the existing data collection and distribution system. Key risks associated with not replacing the existing system are that technologies will become unsupported, bills may not get finished done, constituents won't be represented, negative constituent opinion, emergency measures in time of disaster may be prohibited, and the inability to meet public disclosure mandates.

Key enhancements of the ESI will include:

- Enterprise data repository for immediate and reliable access to critical information.
- Reduced risks of service outages that impact legislative business operations resulting from using current and proven technology.
- Improved data recovery capability due to consolidated and controlled data services, minimizing down time should a service interruption occur.
- Trusted, reliable environment to store critical information within systems that directly support the legislative process.
- Better performance through the use of current technologies.
- Enterprise design and use of technologies and application services for cost-effective purchases of equipment and software.

The requested action is to augment Item 0160-001-0001 by \$1,000,000 and add the following provisional language:

1. Of the appropriation authorized by this item, \$1,000,000 is intended as an initial expenditure to support the Enterprise Strategic Initiative project, which is designed to replace information technology applications that are critical to the mission of the Legislative Counsel Bureau. It is the intent of the Legislature to make additional budget augmentations to fund this project in future fiscal years.

ITEM 8860 DEPARTMENT OF FINANCE**ISSUE 1: REDIRECTION FOR GOVERNOR'S WEB-BASED BUDGET**

The Governor's budget, as amended in the May Revise, requests permanent funding to provide support for the workload associated with the change in publication format for the Governor's Budget and related budget documents from print to a web-based presentation. This request would provide 1.8 Personnel Years (PYs) and \$484,000 General Fund for the evaluation, continuing development, and enhancement of the Governor's Budget Presentation System.

In addition, the Department of Finance (DOF) requests authority to continue the contract with a web development firm through the end of 2005-06 and increase the contract by \$250,000.

COMMENTS

In the current year, the Legislature authorized, through Control Section 4.45, a \$750,000 transfer from the Department of General Services to the DOF for costs associated with producing the Governor's budget through electronic or other media and printed hard copies as necessary.

The 2005 Governor's budget presentation is the initial application of a web-based presentation. Subsequent to that presentation, the DOF surveyed various entities that utilized the web-based budget on how to improve and modify the 2005 presentation.

Through discussions with the Legislative staff, led by Daniel Alvarez of the Senate Budget Committee, the Department of Finance has agreed to continue to provide adequate numbers of bound, hard copies of the budget to the Legislature and to public libraries throughout the state. This will result in an additional cost of \$10,000.

The following provisional language is requested to implement the web-based presentation and provide sufficient print copies for distribution.

From the funds appropriated in Schedule 3 of this item for the purpose of evaluating and continuing development and enhancement of the Governor's Budget Presentation System (GBPS) the following provisions apply:

(a) From time to time, but no later than December 1 of each year, the Department of Finance shall update the Legislature on anticipated changes to the GBPS. In addition, the Department of Finance shall (1) no later than the approximate same time the Governor's Budget is formally presented in electronic or any other web-based form, provide printed and bound hard copies of the Governor's Budget and Governor's Budget Summary as follows: to the Legislative Analyst Office – 45 copies, the Office of the Legislative Counsel – 6 copies, offices of the members of the Legislature – 120 copies, and the fiscal committees of the Legislature – 60 copies, and (2) no later than 4 weeks after the Governor's Budget is formally presented in electronic or any other web-based form, 135 printed and bound hard copies of the Governor's Budget and Governor's Budget Summary shall be provided as follows: 2 copies to the State Library, to ensure that the State Librarian maintain at least one public copy and one for the permanent research collections, and 133 copies: one copy to each depository public library in the state.

Additional copies, either bound or unbound, will be available for purchase by the public based on the cost of producing the documents requested.

(b) Notwithstanding any other provision of law, the Department of Finance may amend its existing contract with the web development firm to augment and continue consulting services through 2005-06 for the purpose of providing continuity of services and to avoid delays in producing the Governor's Budget.

ISSUE 2: BUDGET INFORMATION SYSTEM

The Governor's budget, as amended in the May Revise, requests \$1,749,000 (General Fund) and 1.9 personnel years to provide support for the workload associated with continued development of a Budget Information System (B.I.S.). The purpose of the B.I.S. is to streamline budget processes and develop a year-round integrated budget system to replace the multiple legacy budget systems.

In order to ensure compatibility between the B.I.S. and any other departmental or statewide management systems that may be developed, the Department of Finance (DOF) would like to develop a universal "chart of accounts" to be used by all such systems. This requested change will allow for the development of a chart of accounts and extend the timeframe from 19 months to 31 months. Second and third year funding will be contingent upon approval of a feasibility study report (FSR).

COMMENTS

The State currently lacks a single integrated system for development of the annual budget and for other financial functions, such as accounting and procurement. Existing systems are more than 25 years old and require significant staff support to maintain. These systems, used today to produce the Governor's Budget and other key budget documents, were first developed in the 1970s to capture the incremental changes to the budget.

Without an approved FSR, this is a "cart before the horse" proposal. The FSR will validate the IT components which are the central component of the B.I.S. proposal. Without that information, the Legislature should not approve this funding request.

ISSUE 3: TRAILER BILL LANGUAGE FOR EXECUTIVE COUNCIL FOR BUSINESS MANAGEMENT FUNCTIONS & CONTROL SECTION 8.81

The Administration proposes to add trailer bill that would establish the Executive Council for Business Management Functions. Members of the council would meet at least quarterly and include the Director of Finance (chair), State Treasurer, State Controller, Director of the Department of General Services, Director of the Department of Personnel Administration, State's Chief Information Officer, and several cabinet secretaries. The Council would provide coordinated leadership in the planning and development of systems to be used by state agencies to support business management functions. A key activity would involve establishing an enterprise architecture for business management functions by establishing a chart of accounts.

In addition the Administration has proposed a new Control Section 8.81 to appropriate \$1.25 million General Fund to map the state's enterprise-wide business application development efforts.

COMMENTS

It is not clear that existing state staff and working groups could not accomplish the same objectives as this proposal. Similar large-scale information technology projects, such as the State Controller's Human Resource Management System (21st Century Project) have been developed without the benefit of an executive council.

And, given the ultimate scope and cost of the proposed project, this Control Section cannot be approved without careful deliberation over the long term objective.

ISSUE 4: COORDINATE IN-HOUSE BOND ACTIVITIES

The Governor's budget requests of 3.0 positions (2.9 personnel years) and an increase in reimbursement authority (\$500,000) to fund retainer contracts with financial advisors and bond counsel. In addition, the Department of Finance (DOF) would consolidate bond issuance activities.

COMMENTS

Until a few years ago, the bond issuance was predictable and consisted entirely of General obligation and lease revenue bonds. However, there has been a dramatic increase in the number and types of bond issuances in the last few years. In addition, the DOF has become involved in a number of atypical types of bond issuances, such as Pension Obligation Bonds, Economic Recovery Bonds, Fiscal Recovery Bonds, Tobacco Bonds, Tribal Gaming Bonds, and Grant Anticipation Revenue Vehicles (GARVEE) bonds.

As the workload and types of bond issuances have developed, 3 different units at DOF have been assigned the responsibility of various functions related to bond issuance, such as overseeing, tracking, providing analytic support, coordination with agencies/departments and document preparation. The fragmentation of the workload related to bonds has created difficulties to ensure due diligence is performed for each bond issue. Each unit has been tasked

with developing a relationship with the State Treasurer's Office, bond counsel, and financial advisors. Since many of the units had little awareness that other units might have contracts with these vendors for similar purposes, no coordination of contracts transpired and inconsistent contract pricing may be occurring. In addition, as service vendors are not on retainer, either the State Treasurer's Office or DOF must locate and contract with vendors for each issue, causing delays in the delivery of a bond issue. At present, DOF estimates total time devoted to all bond activities is approximately 6,600 staff hours or approximately 3.7 positions.

Assuming that the consolidation of activities would result in some efficiencies and reduced workload that would be partially offset by refunding, monitoring, and departmental training activities, DOF requests the addition of 3.0 positions and the retainment of service vendors (such as financial advisors and bond counsel), supported through bond proceeds.

NEW CONTROL SECTION ADDITIONAL FEDERAL FUNDS

ISSUE 1: FEDERAL FUNDS

It is anticipated that the State of California will receive more federal funds than expected in the May Revision estimates which will offset General Fund expenditures.

As a result, the following Control Section should be adopted to ensure the budget totals reflect the anticipated receipt of addition federal funds.

SEC XX. Notwithstanding any other provision of law, the Department of Finance shall adjust amounts in any appropriation item, or in any category thereof, to reduce General Fund appropriations by at least \$200 million (\$200,000,000) to directly offset the receipt of additional federal funds.