Senate Budget and Fiscal Review—Denise Moreno Ducheny, Chair

SUBCOMMITTEE NO. 4 Agenda

Michael Machado, Chair
Dick Ackerman
Christine Kehoe

Hearing Outcomes

Monday, April 7, 2008
10:00 a.m.
Room 3191

Consultant: Brian Annis

Public Employment and Finance

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Department Budgets Proposed for Consent / Vote Only

(See consolidated vote-only action on page 7)

Public Employment

8385 California Citizens' Compensation Commission

The seven-member California Citizens' Compensation Commission meets annually and is responsible for setting the salaries and benefits for State Legislators, Governor, Attorney General, Lieutenant Governor, Secretary of State, Controller, Treasurer, Superintendent of Public Instruction, Insurance Commissioner, and Board of Equalization members. The Governor proposes expenditures of $14,000 (all General Fund) and no positions for the Commission – the same amount as 2007-08. The Commission meets annually and is staffed by the Department of Personnel Administration. The Commission budget funds travel expenses and stipends for the annual meeting – Commissioners do not receive a salary.

Control Sections:

Control Section 3.50 - Benefit Charges against Salaries and Wages: Control Section 3.50 of the budget bill specifies what benefit expenditures shall be charged against appropriations from which salaries and wages are paid. The language in this control section is identical to language approved with the 2007 Budget Act.

Control Section 4.01 - Employee Compensation Savings: Control Section 4.01 provides authority for the Director of Finance to adjust Budget Act appropriations for savings from the Alternative Retirement Program and any budget savings achieved through new collective bargaining agreements. Similar language was included in the 2007 Budget Act.

Control Section 4.11 - Establishing New Positions: Control Section 4.11 requires that new positions approved in the budget be established effective July 1, 2008, unless otherwise approved by the Department of Finance. Additionally, it requires the Controller to submit monthly reports to the Department of Finance that lists new positions approved in the budget that will be abolished pursuant to Government Code Section 12439. This control section was first added to the budget in the 2004 Budget Act. Staff understands this control section was added to reduce the practice of departments delaying the establishment of new positions and using the resulting savings for other purposes.

Control Section 4.20 - Contribution to Public Employees' Contingency Reserve Fund: Control Section 4.20 sets the employer's contribution to the Public Employees' Contingency Reserve Fund at 0.450 percent of the gross health insurance premiums paid by the employer and employee for administrative expenses. This rate is adjusted annually, as necessary, to maintain a three-month reserve in the fund. The 2007 Budget Act set the rate at 0.290 percent; however, the Administration indicates a rate of 0.450 is needed for 2008-09 to maintain the three-month reserve. The Control Section additionally allows the Director of Finance to adjust the rate, with a 30-day notification to the Legislature, as necessary to ensure a three-month reserve.

Control Section 11.11 - Privacy of Information on Pay Stubs: Control Section 11.00 requires that all departments distribute pay warrants and direct deposit advices to employees in a manner that ensures that personal and confidential information is protected from unauthorized access. Identical language was approved with the 2007 Budget Act.

Control Section 29.00 - Personnel-Year Estimates: Control Section 29.00 requires the Department of Finance to calculate and publish a listing of total personnel-years and estimated salary savings for each department and agency. These listings must be published at the same time as the publication of: (a) the Governor's Budget; (b) the May Revision; and (c) the Final Change Book. Similar language was approved by the Legislature with the 2007 Budget Act.

Finance

9612 Enhanced Tobacco Settlement Asset-Backed Bonds

This budget item is a technical item that appropriates $1,000 General Fund to repay Enhanced Tobacco Settlement Asset-Backed Bonds if tobacco settlement revenues proved to be insufficient to make 2008-09 bond payments. Budget bill language allows the Director of Finance to increase this item to up to $200 million. While this authority was necessary to sell the Tobacco Settlement Revenue Backed Bonds, it is not anticipated that the General Fund will be required to make any payments. A similar item was approved by the Legislature with the 2007 Budget Act.

9620 Payment of Interest on General Fund Loans

This budget item provides for the payment of interest on loans to the General Fund for internal and external borrowing used to overcome normal cash flow imbalances during the fiscal year. Because receipts and disbursements occur unevenly throughout the fiscal year, the General Fund borrows funds which are then repaid within the same fiscal year. The external borrowing vehicle is known as Revenue Anticipation Notes. The Budget includes $267.8 million (General Fund) in 2008-09 for interest payments. A similar item was approved by the Legislature with the 2007 Budget Act.

9625 Interest Payments to the Federal Government

This budget item provides for the payment of interest to the federal government for federal funds held in State accounts. Under federal law, interest is sometimes required for the period between when federal funds are deposited in a state account and the disbursement of the funds for the program purpose. The Budget includes $30 million (General Fund) in 2008-09 for interest payments. A similar item was approved by the Legislature with the 2007 Budget Act.

9850 Augmentations for Contingencies or Emergencies (Loans)

This budget item provides for loans to state agencies. No loan can be made until 30 days after notification in writing to the Joint Legislative Budget Committee. A similar item was approved by the Legislature with the 2007 Budget Act.

Control Sections:

Control Section 1.80 – Availability of Appropriations: Control Section 1.80 of the budget bill specifies the period of availability for appropriations in the budget. Unless otherwise specified in the budget bill, items of appropriation are available only during the 2008-09 fiscal year, with the exception of capital outlay funds which have a longer period of availability. The language in this control section is similar to language approved with the 2007 Budget Act.

Control Section 3.00 – Defines Purposes of Appropriations: Control Section 3.00 of the budget bill specifies the purposes and limitations of items of appropriation and schedules in the budget bill. The language in this control section is similar to language approved with the 2007 Budget Act.

Control Section 8.50 – Federal Funds Receipts: Control Section 8.50 of the budget bill specifies the intent of the Legislature to maximize federal funds and requires Administration reporting to the Joint Legislative Budget Committee if federal funds fall below budgeted levels, as specified. Note, the procedure for receiving federal funds in excess of budgeted levels is specified in Control Section 28.00. The language in this control section is similar to language approved with the 2007 Budget Act.

Control Section 8.51 – Federal Funds Accounts: Control Section 8.51 of the budget bill requires State agencies to identify to the Controller the account within the Federal Trust Fund against any appropriation made in the budget bill for federal funds. The language in this control section is identical to language approved with the 2007 Budget Act.

Control Section 8.52 – Federal Reimbursements: Control Section 8.52 of the budget bill authorizes the Director of Finance to reduce an item of appropriation upon receipt of in lieu federal funds for the same purpose. Reporting is required to the Joint Legislative

Budget Committee, and Control Section 28.00 is required if the federal funds are not used "in lieu" of an existing expenditure. The language in this control section is similar to language approved with the 2007 Budget Act.

Control Section 8.53 – Notice of Federal Audits: Control Section 8.53 of the budget bill specifies notification to the Joint Legislative Budget Committee when a final federal audit or deferral letter is received. The language in this control section is similar to language approved with the 2007 Budget Act.

Control Section 9.30 – Federal Levy of State Funds: Control Section 9.30 specifies appropriations to be charged in the event that federal courts issue writs of execution for the levy of State funds and such writs are executed. The language in this control section is similar to language approved with the 2007 Budget Act.

Control Section 12.30 – Special Fund for Economic Uncertainties: Control Section 12.30 of the budget bill specifies the amount of General Fund revenue transferred to the Special Fund for Economic Uncertainties matches the amount identified in the Final Change Book for the 2008-09 fiscal year. The language in this control section is similar to language approved with the 2007 Budget Act.

Control Section 26.00 – Intraschedule Transfers: Control Section 26.00 of the budget bill specifies the intent of the Legislature to provide flexibility for the administrative approval of intraschedule transfers within individual items of appropriation, and defines related reporting requirements to the Joint Legislative Budget Committee. The language in this control section is similar to language approved with the 2007 Budget Act.

Control Section 33.00 – Item Veto Severability: Control Section 33.00 of the budget bill specifies that the Governor's veto of certain portions of the budget bill do not affect other portions of the bill. The language in this control section is similar to language approved with the 2007 Budget Act.

Control Section 35.60 – Budget Stabilization Act Transfer to the General Fund: Control Section 35.60 of the budget bill allows the Director of Finance to order the transfer of funds from the Budget Stabilization Account to the General Fund if necessary to maintain a prudent General Fund reserve. The language in this control section is similar to language approved with the 2007 Budget Act.

Staff Comment: No issues have been raised with the budgets or control sections listed above.

Staff Recommendation: Approve all the consent / vote-only budgets and Control Sections.

Action: Approved the vote-only calendar on a 2 – 0 vote, with Senator Kehoe absent during the vote.

Department Budgets Proposed for Discussion

1880 State Personnel Board

The State Personnel Board (SPB) is responsible for California's civil service system. The SPB provides a variety of recruitment, selection, classification, goal setting, training and consultation services to State departments and local agencies. The Board is composed of five members, who are appointed by the Governor, and serve 10-year terms.

The Governor proposes expenditures of $26.1 million ($5.0 million General Fund) and 183.6 positions – an increase of $2.4 million (a General Fund net decrease of $630,000) and an increase of 29.9 positions. Included in these numbers, is a proposed cut of $540,000 to help close the General Fund deficit. The non-General Fund expenditures of the Board are supported by reimbursements for services provided to other State departments.

The proposed budget includes $832,000 (reimbursements) and 8.5 positions to implement SPB's portion of the Financial Information System for California (FI$CAL) information technology project, which would be coordinated by the Department of Finance. Similarly, the Governor requests an augmentation of $116,000 (reimbursements) and a one-year limited-term temporary-help position for SPB's participation in the 21st Century human resources information technology project, which is coordinated by the State Controller's Office. Action on both items should be deferred at this hearing, and then made to conform to the action the Subcommittee takes on the FI$CAL and 21st Century projects when the Department of Finance and State Controller's Office are heard.

Issues Proposed for Discussion / Vote:

1. **Workload Related to Peace Officer Hiring (BCP #9, #10, and part of BCP #2).** The Board submitted 3 BCPs requesting $1.3 million (reimbursements) and 13.0 positions that are primarily driven by recent growth in the number of Officers at the California Department of Corrections and Rehabilitation (CDCR) and the California Highway Patrol (CHP). The SPB work is funded from reimbursements from the hiring departments, and if the workload is not at the predicted level or falls in the future, then the Board would not have sufficient resources to support all the positions and would have to leave some positions vacant. These BCPs do not increase any General Fund budgets, and rejection of these BCPs could slow the hiring of new CDCR Officers and CHP Officers. If the Legislative Analysts Parole realignment option is approved, or other action reduces the level of peace officer hiring, this workload related to these BCPs would fall. However, that would also decrease reimbursements and the SPB expenditures would automatically fall – the 2009-10 budget could be adjusted next year if warranted. The specific requests are as follows:

- BCP #9 increases reimbursement authority by $368,000 and adds 4.0 positions (1.0 Psychologist and 3.0 clerical positions) to administer psychological screening of peace officer applicants. The base level of staffing is 11.0 positions.
- BCP #10 increases reimbursement authority by $295,000 and adds 2.0 positions (1.0 medical officer and 1.0 clerical position) to respond to the increased fitness for duty evaluation workload. The base level of staffing is 2 positions. This workload is primarily related to peace officers, but a portion of workload is related to transportation workers and other classifications.
- Part of BCP#2 increases reimbursement authority by $654,000 and adds 7.0 positions (5 Associate Personnel Analysts and 2 Appeals Assistants) to respond to a projected increase of psychological and medical withhold appeals. The base level of staffing is 10 positions.

Staff Comment: The State has added 360 new CHP officers and attempted to fill more vacant CDCR positions in recent years, and the cost to add or fill these positions has already been incorporated into those departments' budgets, but the SPB budget has not been similarly adjusted to reflect its related reimbursable activities.

Staff Recommendation: Approve these requests.

Action: Held open the issue, and requested additional information from SPB to reconcile these positions with the Administration's peace officer proposals.

2. **Administrative Workload (BCP #6, and part of BCP #2).** The Board submitted 2 BCPs requesting $1.0 million (reimbursements) and 9.5 positions to address ongoing deficiencies in administrative staff.

- Part of BCP #2 increases reimbursement authority by $331,000 to fund 2 additional Administrative Law Judges positions to respond to Whistleblower Retaliation Complaints. The number of complaints has increased from an annual average of 20 in the 1990s to an annual average of about 60 since 2004.
- BCP #5 increases reimbursement authority by $679,000 to add 7.5 positions (5.0 analysts and 2.5 clerical positions) for workload related to business services, accounting, and human resources.

Staff Comment: Staff has reviewed this request for cost avoidance / cost savings and none seem likely in 2008-09. Given this difficult budget year, the Subcommittee may want to reject this BCP without prejudice to consideration of the request in a future year. SPB could either defer improvements to a future year or redirect existing staff as warranted. On the margin, rejection of this BCP would reduce costs for the State agencies who contract with SPB**.**

Staff Recommendation: Reject these requests.

Action: Rejected this request on a 2 – 0 vote with Senator Kehoe absent.

3. **Information Technology Positions (BCP #6).** The Governor requests a total of $234,000 (reimbursements) and 2.0 positions for information technology support. The positions assist in supporting a number of testing, information and management information technology applications. The Board indicates it used to have 18.9 information technology positions, but vacancy reductions and budget cuts earlier in this decade reduced the number to 13.0 positions today.

   Staff Comment: According to the Administration, this request will address an unmet demand for internet-based exams and scheduling systems. SPB currently has over 50 exams and scheduling systems currently on its website. Increasing internet exams and scheduling does increase efficiency in the hiring process and should reduce workload in affected state departments. The efficiency gains are not easily quantifiable, but there should be cost avoidance benefits over the long run.

   Staff Recommendation: Approve this request.

   Action: Approved this request on a 2 – 1 vote with Senator Ackerman voting no.

4. **Technical Training (BCP #8).** The Governor requests a total of $242,000 (reimbursements) and 3.0 positions (1.0 analyst and 2.0 clerical positions) for training and curriculum development services to be performed for State departments. The Board indicates workload in this area has grown due to the closure of the State Training Center.

   Staff Comment: According to the Administration, this is more of a cost shift than a new cost. The amount of training services requested by State departments is somewhat discretionary; therefore, if the demand is not realized, SPB will not receive reimbursements sufficient to fill these positions.

   Staff Recommendation: Approve this request.

   Action: Approved this request on a 2 – 1 vote with Senator Ackerman voting no.

5. **General Fund Budget Reductions (Governor's Budget).** The Governor proposes a budget reduction of $540,000 and elimination of 4.0 positions to help address the General Fund deficit. The Department indicates it would achieve this reduction by eliminating one of the administrative support positions that assist the Executive Office; one manager position overseeing merit appeals and one administrative support position processing merit appeals; one analyst position and $80,000 in contracting dollars from the Bilingual Services Program; and the Assistant Division Chief Position from the Administrative Services Division.

   Staff Comment: Given the severity of the General Fund budget problem, the Subcommittee may want to approve this request and allow the Administration to implement these reductions. In future years, the Administration may submit budget requests to restore some of these positions and funding to the extent the reductions significantly impact core activities.

   Staff Recommendation: Approve the request.

   Action: Approved this request on a 3 – 0 vote.

DPA–Related Public Employment Issues (pages 11-18)

8380 Department of Personnel Administration

The Department of Personnel Administration (DPA) represents the Governor as the "employer" in all matters concerning State employer-employee relations. The Department is responsible for all issues related to salaries, benefits, position classification, and training. For rank and file employees, these matters are determined through the collective bargaining process and for excluded employees, through a meet and confer process.

The Governor proposes expenditures of $106.6 million ($37.8 million General Fund) and 247 positions for DPA – an increase of $6.2 million and 21 positions. Two significant adjustments are a $1.9 million General Fund reduction (and position cut of 11.0 positions) to help address the General Fund deficit, and a $3.0 million General Fund augmentation (and the addition of 28.5 positions) to process layoffs that are part of the Governor's proposal (primarily in the Department of Corrections and Rehabilitation).

The proposed budget included $1.1 million (reimbursements) and 11.0 positions to implement DPA's portion of the Financial Information System for California (FI$CAL) information technology project, which would be coordinated by the Department of Finance. Similarly, the proposed budget includes $623,000 and 6.6 positions to implement DPA's portion of the 21st Century Project information technology project, which is coordinated by the State Controller's Office. Action on both items should be deferred at this hearing, and then made to conform to the action the Subcommittee takes on the FI$CAL and 21st Century Project when the Department of Finance and State Controller's Office is heard.

1. **Drug Testing Program (BCP #4).** The Governor requests $263,000 (reimbursements) to fund higher external laboratory testing costs for several drug testing programs. Some of the drug testing is required pursuant to federal laws (such as some transportation workers), and other testing is authorized by memorandum of understanding with bargaining units (such as Correctional Officers). The BCP indicates that currently about 13,000 employees are tested annually and that number has been growing by about 1,400 employees each year.

   Staff Comment: The State has added new peace officer and transportation workers in recent years, and the cost to add or fill these positions has already been incorporated into those departments' budgets, but the DPA budget has not been similarly adjusted to reflect its related reimbursable activities.

   Staff Recommendation: Approve this request.

   Action: Approved this request on a 3 – 0 vote.

2. **Savings Plus Program – Contract Costs (BCPs #1, 2, & 3).** The Governor requests a total of $1.2 million (special fund) to fund increased costs for the Third Party Administrator and consultants for the Savings Plus Program and the Alternative Retirement Program. Funding for these activities comes from State employees who participate in the programs – funds either come directly from monthly administrative fees, or reimbursements received from the programs' investment providers. Similar requests have been approved over the past several years. The specific BCP requests are as follows:

   - BCP #1 increases deferred compensation by $512,000 and reimbursement authority by $332,000 for providing recordkeeping and trustee services to the State's 457 and 401(k) Defined Contribution Plans and the State's Alternative Retirement Program (ARP). The cost increase is due to participation growth in these plans.
   - BCP #2 increases reimbursement authority by $100,000 to implement the Payout Selection phase of the State's Alternative Retirement Program (ARP). ARP was implemented in August 11, 2004 for new State hires, and allows employees to choose a payout option in month 47–49. The participants can either retain the funds in the ARP defined contribution plan or shift the funds to CalPERS to "buy" credit into CalPERS for their first two years of State service to improve their defined benefit plan payout.
   - BCP #3 increases deferred compensation by $260,000 for external investment consulting services necessary to support the new investment portfolio structure. The Department indicates that the new portfolio structure will improve the return on participants' investments exceeding the cost of implementation.

   Staff Comment: This request funds external costs for the Savings Plus and Alternative Retirement Program. This augmentation would be fully paid by the participants in the programs.

   Staff Recommendation: Approve these requests.

   Action: Approved these requests on a 3 – 0 vote.

3. **Projected State Layoffs (BCP #6).** The Governor requests a two-year limited-term augmentation of $3.0 million (General Fund) and 28.5 positions to address layoff workload that would occur if the Governor's Budget is adopted as proposed. DPA estimates layoffs could number 7,200 out of the total State workforce of 235,000. The majority of the layoffs in the Governor's plan would come from the California Department of Corrections and Rehabilitation (CDCR) where 5,854 positions are proposed for elimination.

   Staff Comment: This issue should be held open pending actions on other proposals – primarily the CDCR proposal.

   Staff Recommendation: Hold this issue open.

   Action: Held open the issue, and requested additional information from DPA to reconcile these positions with 2003-04 layoff staffing. Additionally, held open to reconcile with actions in other areas that impact layoff staffing.

4. **General Fund Budget Reductions - Administrative (Governor's Budget).** The Governor requests budget reductions totaling $1.4 million and 10.5 positions in DPA's administrative areas to help close the General Fund deficit. The reductions are outlined by DPA division as follows:

   - Classification and Compensation Division – a reduction of $398,000 and 2.9 positions is requested. The Administration indicates the impact of this reduction may delay implementation of critical (health and safety) classification and compensation changes. This could result in the inability of departments to hire qualified staff and meet statutory requirements primarily in level-of-care agencies such as Developmental Services and Mental Health and public safety agencies such as CDCR. Staffing reductions may also delay the grievance process.
   - Labor Relations Division – a reduction of $239,000 and 1.9 positions is requested. The Administration indicates the impact of this reduction will be that the State will have less comprehensive data with which to compare compensation for state classifications with local agencies and private industry.
   - Legal Division – a reduction of $403,000 and 2.9 positions is requested. The Administration indicates the impact of this reduction will be that the Division's litigation options will be restricted due to decreased travel budgets. Travel activities include fact finding, interviewing witnesses, and attending hearings. DPA will require witnesses to travel to Sacramento. Existing attorneys will work longer hours and handle more cases.
   - Administrative Services Division – a reduction of $119,000 and 0.9 positions is requested. The Administration indicates the impact of this reduction will be reduced or eliminated services to the DPA internal and statewide programs.

- Benefits Program – a reduction of $226,000 and 1.9 positions is requested. The Administration indicates the impact of this reduction could be reduced efficiencies in providing statewide benefits administration.

Staff Comment: Given the severity of the General Fund budget problem, the Subcommittee may want to approve this request and allow the Administration to implement these reductions. In future years, the Administration may submit budget requests to restore some of these positions and funding to the extent the reductions significantly impact core activities.

Staff Recommendation: Approve these requests.

Action: Approved the request on a 3 – 0 vote.

5. **General Fund Budget Reductions - Rural Health Care Equity Program (Governor's Budget).** The Governor requests a reduction of $515,000 and approval of trailer bill language to reduce Rural Health Care Equity Program (Program) annual payments from $500 to $450 for each recipient. The Program provides subsidies for current and retired State employees who reside in a rural area not served by a health maintenance organization (HMO).

Staff Recommendation: Approve this request.

Action: Approve the request on a 3 – 0 vote.

Department of Personnel Administration / State Compensation Insurance Fund – Cross Cutting Issues.

Last year, the Subcommittee discussed the administration of the workers' compensation system for State employees and the roles of the Department of Personnel Administration (DPA), the State Compensation Insurance Fund (SCIF), and individual employing departments play in providing administration, support, and oversight for the program. As a result of the discussion, DPA issued a management memo to departments to restate their responsibilities for the Administration of workers' compensation, and the master agreement between DPA and SCIF was revised. Additionally, the Legislature selected a large department (Department of Transportation (Caltrans), to audit for its administration of the system. The Office of State Audits and Evaluation (OSAE) study should be complete at the end of April.

Issue proposed for Discussion:

1. **Cost of the Workers' Compensation for State Employees (Informational Issue).** The cost to the State for employees' workers' compensation is displayed in the below table, although actual budget authority is provided in the budgets of individual departments that reimburse SCIF as costs are incurred, and therefore both the General Fund and special funds are included in the costs. The table below shows the change in State workers' compensation costs from 2004-05 through SCIF estimates for 2008-09.

	2004-05	2005-06	2006-07	2007-08*	2008-09*
SCIF Admin Costs	$56.1	$60.7	$68.0	$72.0	$76.0
Cost of Benefits	$439.5	$398.3	$399.3	$406.0	$417.0
Total State Costs	**$495.6**	**$459.0**	**$467.4**	**$478.0**	**$493.0**
Total New Claims	25,546	26,095	25,164	24,500	24,620

* SCIF estimates

Staff Comment: As indicated above, the Office of State Audits and Evaluation workers' compensation audit of Caltrans should be completed in late April. That audit will provide insight into how one large State department is fulfilling its responsibility to administer the workers' compensation system. Staff also notes that the $4.0 million Administrative Cost increase actually breaks down to a $1.3 million reduction in external costs (bank charges, pro rata, etc.,) and a $5.3 million increase in SCIF administrative costs.

SCIF's workers' compensation case inventory is fairly unchanged year-over-year, but SCIF is adding about 20 positions, primarily to meet utilization revenue requirements outlined in Department of Industrial Relations regulations. Over time, staff has been added to SCIF to both address new regulatory requirements, and to bring caseload averages down.

The Subcommittee may want to hear from SCIF and DPA on the changes they have instituted over the past year to improve the administration and oversight of workers' compensation for State employees. Additionally, SCIF should be prepared to discuss staff growth and the impact of deferring staff growth in 2008-09 to reduce State costs.

Staff Recommendation. Hold open. Direct staff to review the audit report when it is complete and bring the findings back to the Subcommittee at a future hearing if warranted.

Action: Held open. Directed staff to bring back for further discussion, if warranted, after the release of the Caltrans workers' compensation audit.

9800 Augmentation for Employee Compensation

This budget item includes funding for pay and benefit increases for those costs that exceed the baseline costs already included in individual department budgets. Generally, this item includes employee compensation funding based upon approved Memoranda of Understanding (MOU) with the State's 21 bargaining units and funding for health benefit inflation. Also included is compensation increases for excluded employees as is determined by the Department of Personnel Administration or other authorized entities. All bargaining units except Unit 5 (California Highway Patrol Officers) have expired contracts or contracts that will expire at the end of 2007-08.

The Governor's Budget proposed $646 million ($392 million General Fund) in Item 9800. Included in this amount is a funding request of $260.4 million General Fund for the Last, Best, and Final Offer of the Administration to the California Correctional Peace Officers Association (CCPOA), although no policy bill to implement that offer has been introduced to date. The LAO indicates that the *total* cost for State employees' salary is about $23 billion, with an additional $7 billion for benefits and other related costs (including universities for both cost measures). The General Fund supports more than one-half of this total.

Discussion / Vote Issues:

1. **9800 Assumptions:** The following estimates of major costs are included in the budget requests:
   - Unit 6 CCPOA – assumes implementation of the Last, Best, and Final Offer and budgets $260 million General Fund in 2007-08 and $260 million General Fund in 2008-09.
   - Unit 5 (CHP Officer) and Unit 9 (Engineers) – includes $9 million General Fund and $198 million special fund for existing contractual pay increases for these two units (the Unit 9 contract expires July 2, but includes a July 1 pay increase).
   - Plata, Coleman, and Perez Lawsuit / Non-Corrections Medical Professions – includes a total of $44 General Funds for cost growth in 2008-09 related to lawsuits brought against the state for prison medical care. These pay adjustments are not mandated by the lawsuits, but have been implemented for pay equity and recruitment / retention issues.
   - Health, Dental and Vision Inflation – includes $32 million General Fund and $43 million other funds.
   - Other Multi-year Salary Agreements / and Excluded Pay – includes funding for multi-year implementation of Game Warden salary increases and augmentations for other multi-year agreements, and excluded employees (a total of about $46 million General Fund and $12 million other funds).

   LAO Recommendation: In the *Analysis of the 2008-09 Budget Bill*, the Legislative Analyst recommends two budget changes: (1) reject funding of $260 million (General Fund) for the CCPOA Last, Best, and Final Offer because the current pay appears sufficient to meet staffing needs, and (2) reject $550,000 (General Fund) for a new pay differential for information technology employees working on the Human

Resources Management System (HRMS) project because the Administration does not have a comprehensive plan for when and how to apply this differential in the future to other enterprise projects. The LAO also has recommendations related to future bargaining agreements, which would be only informational for this committee, because bargaining agreements are approved through the policy committees.

Staff Comment: For consistency, the Subcommittee may want to move the funding for CCPOA out of this item, with the intent that funding would be included in a policy bill that implements a future MOU. When the budget was developed, the Administration may have anticipated enactment of a policy bill to implement their Last, Best, and Final Offer, but no policy bill has been introduced to date. Since the timeline for a CCPOA MOU now seems consistent with the timeline for other bargaining units with expired or expiring MOUs, it may make more sense, and be more in keeping with standard budget procedure, to remove this funding from the budget.

Staff Recommendation: Hold open because there are typically May Revision adjustments to this item.

Action: Held open, except rejected the $550,000 ($331,000 General Fund) budgeted for a new pay differential for information technology employees working on the Human Resources Management System.

1920 State Teachers' Retirement System

The State Teachers' Retirement System (STRS) administers retirement and health benefits for more than 800,000 active and retired educators in the public schools from kindergarten through the community college system. Unlike public employees covered under the California Public Employees' Retirement System (PERS), STRS members do not participate in the social security system. According to the most-recent actuarial analysis, STRS is about 87 percent funded for estimated long-term obligations (relative to a 86 percent funded level last year) , leaving an unfunded liability of $19.6 billion. The LAO indicates that this funding level is above average among large public pension systems – with the average U.S. pension system about 85 percent funded.

Proposition 162, approved by voters in 1992, amended the California Constitution to provide the STRS Board with authority over the administration of the retirement system. However, the STRS operations budget is still a Budget Act appropriation which the Legislature adopts. The STRS Board adopted a 2008-09 budget that anticipates benefit and administrative expenditures of $8.8 billion (and 846.8 positions) – up $659 million (and 67.1 positions) from 2007-08. Administration, including services to members and employers, is up about $43.8 million (to $178 million), and benefit costs are up about $616 million (to $8.7 billion). In the 6300 Budget Item, the Governor is proposing $1.120 billion (General Fund) in State contributions to STRS – down from the $1.623 billion provided in 2007-08. However, the year-over-year change is primarily driven by a one-time legal decision that is further discussed below.

<u>The State funds teachers' retirement based on two statutory formulas:</u>

- Benefits Funding – the State's contribution is statutorily based on 2.017 percent of the teachers' salaries. The 2008-09 cost is budgeted at $536 million General Fund.
- Supplemental Benefit Maintenance Account (SBMA) – The State's contribution is fixed by statute at 2.5 percent of teachers' salaries and is intended to provide retiree purchasing power protection. The 2008-09 payment as dictated by statute is $664 million. While the budget reflects this amount, there are two Administration proposals that produce a net-zero change in the SBMA payment: (1) the Administration is proposing statutory changes to vest purchasing power protection at 80 percent of initial retirement level (for a savings of $80 million); and (2) the Administration is proposing to pay $80 million in interest payments (out of about $210 million in interest due) from litigation the State lost related to a 2003-04 budget action. Both of these are further discussed below.

<u>The State lost its appeal on STRS SBMA lawsuit:</u>

In 2007, the State lost its appeal to a case brought by STRS over a 2003-04 budget action that reduced that year's SBMA payment by $500 million. In September 2007, the State paid the $500 million in principle to STRS. Interest due is about $210 million, but the judgment did not specify an interest payment due date and the Administration is only proposing to pay $80 million of the $210 million in 2008-09.

Issues for Discussion and Vote:

1. **Purchasing-Power-Protection Vesting & Related Savings (Governor's Budget Trailer Bill).** The proposed budget reduces the Supplemental Benefit Maintenance Account (SBMA) State contribution from 2.5 percent of salary to 2.2 percent – for an annual estimated savings of about $80 million (from reducing this contribution from $622 million to $547 million). The Administration indicates that this contribution level is sufficient to maintain the existing purchasing-power-protection benefit based on a 2005 actuarial analysis. In return, the Administration proposes to vest this purchasing-power-protection benefit at 80-percent of an individual's initial retirement allowance (instead of the current vesting that sets the State's contribution at 2.5 percent of salary without a vested level of purchasing-power-protection). Because the funding cut would be tied to a new vested benefit, the Administration argues this proposal is substantially different from the 2003-04 suspension that the State lost in litigation (see last page).

   Background / Detail: Last year, the Administration proposed a similar plan that was rejected by the Legislature. However, this year's plan differs in that the proposed language would allow the annual State contributions to be determined by STRS to the level necessary to maintain the 80 percent benefit (and not fixed at 2.2 percent of payroll as proposed last year).

   Since the January Governor's Budget, the STRS Board has adopted a recommended alternative and the California Retired Teachers' Association (CRTA) has also released an alternative. The three proposals are as follows:

   - **Governor's Proposal:**
     - Change vesting from 2.5 percent of payroll to 80 percent of purchasing power to save an estimated $80 million annually. (Current law pays at the 80-percent level, but that is not a vested benefit and could fall if 2.5 percent of payroll is insufficient to continue that level of payment.)
     - Change annual State payments to STRS from July 1 to November 1 and April 1 to improve General Fund cashflow. (Legislation was approved in the Special Session to move the 2008-09 payment to November 1, 2008 on a one-time basis).
     - Make the lawsuit interest payment over three years, beginning with $80 million in 2008-09 (about $130 million [plus interest on this interest] would remain to be paid in 2009-10 and 2010-11)
     - Pros: (1) saves the State $80 million in 2008-09 (and an additional $130 million from the deferral of interest payments) and may continue to provide savings as long as inflation does not exceed expectations; (2) ensures purchasing power protection for retired teachers will not fall below 80 percent.
     - Cons: (1) increases financial risk to the State – if inflation increases beyond

expectations (the assumption is that inflation will average 3.25 percent) all savings could erode and the State General Fund would have to pay whatever amount is necessary to maintain the benefit at 80 percent; (2) this proposal is opposed by STRS and the CRTA increasing the risk of litigation.

- **STRS's Proposal:**
  - Same as the Governor's proposal except changes the new vested benefit from 80 percent of purchasing power to 82.5 percent of purchasing power. STRS indicates that saving should still be estimated at $80 million annually. No net change in General Fund costs in 2008-09 relative to the Governor's proposal.
  - Pros: (1) saves the State $80 million in 2008-09 and may continue to provide savings as long as inflation does not exceed expectations; (2) increases retirement income for individuals who participate in the program and ensures purchasing power protection for retired teachers will not fall below 82.5 percent; and (3) the proposal is supported by STRS reducing the risk of litigation.
  - Cons: (1) increases financial risk to the State (even above that of the Administration's proposal) – if inflation increases beyond expectations (the assumption is that inflation will average 3.25 percent) all savings could erode and the State General Fund would have to pay whatever amount is necessary to maintain the benefit at 82.5 percent; (2) this proposal is opposed by CRTA increasing the risk of litigation.

- **CRTA's Proposal:**
  - Reduces vesting from 2.5 percent of payroll to 2.25 percent of payroll in exchange for a statutory, but non-vested, increase in the purchasing power protection level to 85 percent of initial retirement income.
  - Retains the annual payment deferrals in the Governor's plan (annual payments would be made in November and April).
  - Delays interest payments by deleting the 2008-09 payment and adding a 2011-12 payment. This would produce additional General Fund savings of $80 million in 2008-09 (but add to 2011-12 General Fund costs).
  - Pros: (1) saves the State $144 million in 2008-09 ($64 million more than the Administration) and does not obligate the State to increase payments if inflation exceeds expectations; (2) increases retirement income for individuals who participate in the program (by more than the STRS plan) but does not provide a vested guarantee that the payments cannot be reduced in the future below 85 percent.
  - Cons: (1) places a new non-vested pressure on the State to continue benefits at the 85 percent level (and increase State General Fund costs if inflation is high), even if there is ability to change statute to reduce the benefit; (2) does not provide retired teachers a vested guarantee that the payments cannot be reduced in the future below 85 percent; (3) STRS has not taken a position on this proposal, but opposition from STRS could increase the risk of litigation.

LAO Recommendation: The Legislative Analyst recommends that the Legislature reject the Administration's vesting proposal. The LAO finds there are risks in creating a new vested benefit, because under certain inflation assumptions, the proposal could increase State costs over the long-term (instead of producing the annual savings of about $80 million as the Administration calculates). Additionally, the LAO recommends paying the full $210 million interest obligation in 2008-09 because the judgment may not provide the State discretion to pay over time, and in addition STRS, legal action may require full payment in 2008-09.

Staff Comment: STRS contracted for an actuarial analysis that included some statistical tests for the sensitivity of savings to inflation estimates. The actuary indicates that the projected saving is very sensitive to the inflation assumption. The base inflation assumption is 3.25 percent, but if inflation averages 3.50 instead, all of the savings is lost, and the State would incur higher costs. The actuary also performed a stochastic analysis that looked at inflation averaging 3.25, but with an annual standard deviation of 2.0 percent – in this case there is 35 percent risk of a cumulative net cost to the State over a 30-year period.

Staff Recommendation: Keep open for the May Revision.

Action: Held open. Note, the prior page of the agenda indicates that the California Retired Teachers' Association (CRTA) opposes the CalSTRS alternative – the CRTA indicates that this is incorrect and that the CRTA Board has not taken a position on the CalSTRS proposal.

CalPERS–Related Public Employment Issues (pages 22 – 29)

1900 Public Employees' Retirement System

The Public Employees' Retirement System (PERS) provides benefits to about one million active and inactive members and about 441,000 retirees. PERS membership is divided approximately in thirds among current and retired employees of the State, schools, and participating public agencies. The Constitution grants the PERS Board "plenary authority and fiduciary responsibility for investments of moneys and administration of the system" as specified. PERS sets the State's retirement and healthcare contribution levels – consistent with union contracts negotiated by the Governor and approved by the Legislature, and vested benefits. This budget item shows PERS benefits and administrative expenditures. State retirement contributions for current employees are built into individual department budgets and Control Section 3.60 (see also the "Control Section 3.60" section later in this agenda). State funding for 2007-08 Health and Dental Benefits for Annuitants is contained in Budget Item 9650 (see also the "9650 Health and Dental Benefits for Annuitants" section later in this agenda). The special authority provided to PERS by the Constitution does not extend to the component of the Health Benefits Program funded from the Public Employees' Contingency Reserve Fund, and, therefore, PERS submits BCPs and Finance Letters to the Legislature for budget changes in those areas.

The PERS Board adopted a 2008-09 budget that anticipates benefit and administrative expenditures of $14.9 billion (and 2,184.5 positions) – up $1.2 billion (and down 1.5 positions) from 2007-08. Administration is relatively unchanged at $320 million, so this increase is due to increased benefit costs. However, it should be noted that CalPERS also considers mid-year budget revisions which have been substantial in the past – for example the 2007-08 mid-year revisions increased administrative expenditures by about $31 million and 54 positions. The State's retirement contribution for current employees is estimated at $2.8 billion (including $1.6 billion General Fund) – an increase of $80 million (including a $45 million General Fund increase) relative to 2007-08. The State's 2008-09 cost for health and dental benefits for annuitants is estimated at $1.3 billion General Fund – an increase of $143 million. However, the retiree healthcare cost is adjusted after the enactment of the budget to collect the special fund share through the pro rata process – so the final General Fund cost is actually reduced by about $561 million.

According to a June 2006 actuarial analysis, PERS is about 87 percent funded for estimated long-term obligations, leaving an unfunded liability of $29 billion. These figures are based on the actuarial value of assets methodology that includes some asset smoothing to adjust for short-term fluctuations.

(See next page for issues).

CalPERS Budget Change Proposals: None of the proposed BCPs would be funded directly from the General Fund. However, the Department of Finance indicates that the state General Fund would ultimately be responsible for about one-third of the cost (the other two-thirds would be paid by local governments and State special funds). The Department of Finance indicates that it was able to quantify General Fund cost savings / cost avoidance in BCP #2 and #6 that totals to about ~~$1.3 million~~ $742,000 – corrected. This exceeds the total General Fund cost of $735,000 for all BCPs and results in net General Fund savings of ~~$613,000~~ $6,500 – corrected. Most of the other BCPs indicate cost savings / cost avoidance, but the expected amount is not quantified.

Proposed Consent / Vote Only:

1. **Public Agency Contracts (BCP #2).** PERS requests $235,000 (Contingency Reserve Fund) and 2.0 new positions to support increased core workload for contract management activities. PERS indicates that the workload increase is driven as more agencies join the Public Employees' Medical and Hospital Care Act (PEMHCA). PEMHCA provides a variety of health plans covering 1.2 million lives with participation from over 1,100 participating public employers. Additionally, the BCP indicates that failure to retain agencies will decrease the PEMHCA risk pool and result in higher health care costs for all PEMHCA members and employers, including the State of California. The Department of Finance estimates approval of this proposal will result in General Fund savings of $1.2 million.

   Action: Approved the request on a 3 – 0 vote.

2. **Quality Control and Special Projects Unit (BCP #6).** PERS requests $216,000 (Contingency Reserve Fund) and 2.0 new positions to support core workload for the Enrollment and Eligibility Unit under the Public Employees' Medical and Hospital Care Act (PEMHCA). This program is responsible for determining the health benefit eligibility of all prospective enrollees, and for processing the health benefit enrollments of over 1.2 million total covered individuals. PERS indicates many individuals are retiring earlier in their careers resulting in more workload. The Department of Finance estimates approval of this proposal will result in General Fund savings of $120,000 (versus a General Fund share of cost of about $70,000).

   Action: Approved the request on a 3 – 0 vote.

3. **Rate Development and Renewal (BCP #1).** PERS requests $417,000 (Contingency Reserve Fund) and 3.0 new positions to support program changes that will increase the ability to achieve cost avoidance. PERS indicates that for the 2008 rate year, the existing staff of 3.0 positions found $32 million in savings through use of the Health Care Decision Support System and validated a total of $144 million saved in the final rate quotes. CalPERS indicates that if this proposal is rejected, the State will lose the opportunity to generate additional healthcare savings – while the marginal new saving is not quantified, the past actual savings data suggest there is the potential for significant cost savings from the new positions.

   Action: Approved request on a 2 – 1 vote, with Senator Ackerman voting no.

4. **Health Information System Services Web-based Solutions (BCP #4).** PERS requests $646,000 (Contingency Reserve Fund) and 3.0 new positions to support Electronic Health Records (HER) and Health Information Technology (HIT) initiatives. The request includes $250,000 for external contracts. PERS indicates that these positions will lead web-based product development, and support front-end Medicare Part D subsidy claims processing. CalPERS indicates that if this proposal is rejected, the State will lose the opportunity to generate cost savings by realizing more federal subsidies in the Medicare Part D Low Income Subsidy.

Action: Approved request on a 2 – 1 vote, with Senator Ackerman voting no.

Staff Recommendation: Approve these requests.

Issues proposed for Discussion / Vote:

5. **Health Program Receivables (BCP #3).** PERS requests $352,000 (Contingency Reserve Fund) and 3.0 new positions to support core workload for Health Program Financial Receivables under the Public Employees' Medical and Hospital Care Act (PEMHCA). Two positions would specifically work in the Complementary Annuitant Premium Program (CAPP) that deals with approximately 1,400 individual annuitants whose retirement warrants are not sufficient to cover their health premiums – PERS indicates this workload has doubled in the past four years without a staffing increase. One position would work in the Public Agency Billing Unit to increase coordination with the Collections Unit.

   Staff Comment: Staff has reviewed this request for direct cost avoidance / cost savings and none seem likely in 2008-09. Given this difficult budget year, the Subcommittee may want to reject this BCP without prejudice to consideration of the request in a future year. PERS could either defer improvement to this program to a future year or redirect existing staff as warranted. On the margin, rejection of this BCP would reduce costs for the State and local governments who participate in PERS.

   Staff Recommendation: Reject this request.

Action: Rejected request on a 3 – 0 vote.

6. **Quality Control and Special Projects Unit (BCP #5).** PERS requests $117,000 (Contingency Reserve Fund) and 1.0 new position to implement quality control functions and facilitate a revitalized training program in the Data Reconciliation Unit.

   Staff Comment: Staff has reviewed this request for direct cost avoidance / cost savings and none seem likely in 2008-09. Given this difficult budget year, the Subcommittee may want to reject this BCP without prejudice to consideration of the request in a future year. PERS could either defer improvement to this program to a future year or redirect existing staff as warranted. On the margin, rejection of this

BCP would reduce costs for the State and local governments who participate in PERS.

Staff Recommendation: Reject this request.

Action: Rejected request on a 3 – 0 vote.

7. **Health Educators (BCP #7).** PERS requests *no* new funds and 2.0 new positions to accomplish education and communications activities for PERS staff, members, and employers. No new funding is requested because PERS generally receives "training" and "administrative cost" operating expense funding when positions are approved in BCPs for other purposes. The administration felt it could absorb the cost of these new positions using the training/administration funding added to the budget in BCPs this year and in recent past years.

   Staff Comment: Staff has reviewed this request for direct cost avoidance / cost savings and none seem likely in 2008-09. Given this difficult budget year, the Subcommittee may want to reject this BCP without prejudice to consideration of the request in a future year. PERS could either defer improvement to this program to a future year or redirect existing staff as warranted. Additionally, due to the difficult budget year, the Subcommittee may want to reduce the PERS operating and equipment budget by $235,000 (the approximate amount that would have otherwise been redirected for this purpose, and the amount of funding requested in BCP #2 for 2.0 positions of the same classification). About one-third of the requested savings (about $78,000) would benefit the General Fund.

   Staff Recommendation: Reject this request and cut PERS funding in this area by $235,000.

Action: Rejected request, and reduced the budget by $235,000 on a 3 – 0 vote.

8. **Contract Management and Oversight (April Finance Letter).** PERS requests $359,000 (Contingency Reserve Fund) and 3.0 new positions (two-year limited term) to audit Health Maintenance Organization (HMO) operations to determine their actual costs for physicians, overhead, plant utilization, pharmaceutical contracts, etc. Together with the data that HMOs have to provide pursuant to AB 1296 (Ch 698, St 2007), this will enable PERS to more effectively negotiate health care rates.

   Staff Comment: Since the total health benefit cost is in excess of $3.5 billion for PERS enrollees, even relatively small changes to rates can result in large savings.

   Staff Recommendation: approve this request.

Action: Approved request on a 2-1 vote with Senator Ackerman voting no.

9650 Health and Dental Benefits for Annuitants

This budget item provides funding for health and dental benefit services for more than 210,000 retired state employees and their dependents. The cost split between annuitants and the State is set by Government Code 22871, which establishes a "100/90" formula. Under the formula, the average premiums of the four largest health plans sets the maximum amount the State will contribute to an annuitant's health benefit. The State contributes 90 percent of this average for the health benefits of each of the retiree's dependents. The California Public Employees' Retirement System (PERS) negotiates health care rates with providers and future negotiations will affect the final cost to the State. Revised cost figures should be available in May or June. This funding covers 2008-09 costs and does not provide money to begin pre-funding retirement health costs for current State employees.

Budget Item 9650 includes $1.281 billion ($1.262 billion General Fund, and $19 million Medicare Part-D federal reimbursements) for Health and Dental Benefits for Annuitants – an increase of $143 million. However, the retiree healthcare cost is adjusted after the enactment of the budget to collect the special fund and federal share through the pro rata / SWCAP process – so the final General Fund cost is actually reduced by about $561 million. The LAO indicates that the Administration's cost figures assume a 3 percent growth in retirees and a 9.5 percent increase in premiums.

Staff Comment: Because final costs are not known until late May or early June, this issue is presented for informational purposes at this point. There may not be an opportunity for public testimony when the final number is provided; therefore, the Subcommittee may want to receive testimony from the LAO, the Administration, and the public at this hearing.

Staff Recommendation: Hold the budget for this item open for the May Revision, or Conference Committee, pending final cost numbers from CalPERS.

Action: Held open for anticipated May Revision changes.

Control Section 3.60 Contributions to Public Employees' Retirement Benefits

Control Section 3.60 of the budget bill specifies the contribution rates for the various retirement classes of State employees in the California Public Employees' Retirement System (CalPERS). This section also authorizes the Department of Finance to adjust any appropriation in the budget bill as required to conform to changes in these rates.
The State's contributions to CalPERS in 2008-09 are currently estimated at $2.8 billion ($1.6 billion General Fund) – an increase of $80 million over 2007-08 (including a $45 million General Fund increase). The following table provides proposed rates with historical comparisons, and is copied from the LAO's *Analysis of the 2008-09 Budget Bill*.

Figure 1

State Retirement Contribution Rates

1995-96 Through 2008-09 (As Percent of Payroll)

Fiscal Year	Misc. Tier 1	Misc. Tier 2	Industrial	Safety	Peace Officer/ Firefighter	Highway Patrol
1995-96	12.4%	8.3%	9.0%	14.2%	14.4%	14.8%
1996-97	13.1	9.3	9.3	14.7	15.4	15.9
1997-98	12.7	9.8	9.0	13.8	15.3	15.5
1998-99	8.5	6.4	4.6	9.4	9.6	13.5
1999-00	1.5	—	—	7.5	—	17.3
2000-01	—	—	—	6.8	2.7	13.7
2001-02	4.2	—	0.4	12.9	9.6	16.9
2002-03	7.4	2.8	2.9	17.1	13.9	23.1
2003-04	14.8	10.3	11.1	21.9	20.3	32.7
2004-05	17.0	13.2	16.4	20.8	23.8	33.4
2005-06	15.9	15.9	17.1	19.0	23.6	26.4
2006-07	17.0	16.8	17.9	19.3	24.5	31.5
2007-08	16.6	16.6	17.3	18.8	25.6	32.2
2008-09[a]	16.6	16.6	17.3	18.8	25.6	32.2

[a] Budgeted.

Staff Comment: The above rates show significant annual fluctuations, which is primarily based on the investment market. The rates in 2005-06 through 2008-09 reflect CalPERS' new rate stabilization policy, which builds gains and losses in the value of assets into the actuarial calculation of the plans' asset value, over 15 years, instead of the three years of the prior policy. While the rates generally stay flat in 2008-09 due to investment growth (investments grew about 19 percent in 2006-07, compared to the system's normal projected investment return of under 8 percent annually), the overall State contribution rises by $80 million primarily because of payroll growth. The LAO

notes that the pension fund is 87 percent funded (or has a $29 billion unfunded liability) based on the smoothing methodology that the Board uses to assess contributions from the State. However, using an un-smoothed current market value approach, the pension fund is 93 percent funded (or has a $17 billion unfunded liability). The LAO indicates that this funding level is above average among large public pension systems – with the average U.S. pension system about 85 percent funded.

Issues for Discussion:

1. **PERS Revision of 2007-08 Retirement Contribution Rates.** As was indicted in the CalPERS section of this agenda, Proposition 162, approved by voters in 1992, amended the California Constitution to provide the PERS Board of Administration with authority over the administration of the retirement system and set contribution rates. The CalPERS Board is expected to adopt new rates at their May meeting. The budget will then be adjusted to reflect the new rates and costs.

   Staff Comment: The Administration expects to submit a May Finance Letter to reflect the adjusted rates.

   Staff Recommendation: Hold open until the May Revision.

   Action: Held open for anticipated May Revision changes.

2. **LAO Issue.** In the *Analysis of the 2008-09 Budget Bill*, the Legislative Analyst withholds recommendation on the retirement contribution rates pending CalPERS action on the adoption of revised rates in May. The LAO recommends the CalPERS communicate unfunded liability such that the information provided is consistent with how the budget is set – that inconsistent information on unfunded liability may confuse policy makers and the public.

   Staff Comment: The Subcommittee may want to hear from both the LAO and PERS on this issue, to discuss the two different methodologies PERS uses to estimate unfunded liabilities.

   Staff Recommendation: Informational only.

   Action: No action – informational item. The Chair did indicate to CalPERS the preference of the Committee that actuarial information be clearly explained and not overly focused on short-term market fluctuations.

0860 Board of Equalization

The Board of Equalization (BOE) administers the sales and use tax programs, administers a variety of business and excise taxes and fees, and oversees the administration of the property tax by county assessors. The BOE is governed by a five-member board, consisting of four regionally elected members and the State Controller. The Board is also the final administrative appellate body for personal income and corporation taxes, which the Franchise Tax Board administers.

The Governor proposes expenditures of $430 million ($242 million General Fund) and 4,035 positions for BOE – an increase of $33 million ($20 million General Fund) and an increase of 235 positions. The new positions are primarily associated with activities that will decrease the "tax gap," which is the $2.0 billion annual difference between BOE taxes owed and taxes collected. The Board estimates the requested tax-gap positions will increase General Fund revenues by over $32 million in 2008-09.

Issues Proposed for Consent / Vote-Only

1. **Cigarette and Tobacco Programs (BCP #4).** The Administration requests $3.0 million ($238,000 General Fund), 13.0 new positions, and conversion of 20.0 limited-term positions to permanent, to enhance enforcement and voluntary compliance in the cigarette and tobacco product tax programs. The majority of the requested positions would work in the compliance and audit areas to address ongoing and new workload related to out-of-state tax avoidance, accounts receivable recovery, and tax audit activities. These efforts are expected to increase revenue by $30.1 million ($1.5 million General Fund) in 2008-09 and by $43.2 million ($1.9 million General Fund) in 2009-10. In addition to the General Fund benefit, the additional revenue collection would benefit programs funded out of the Breast Cancer fund, the Cigarette and Tobacco Products Surtax fund, and the California Children and Families First Trust Fund. The current tax is $.87 per pack of cigarettes.

2. **Agricultural Inspection Station Program (BCP #5).** The Administration requests $1.4 million ($800,000 General Fund), to continue for two years 16.0 limited-term positions that are associated with the Agricultural Inspection Station Tax Leads Pilot Program. Under this program, BOE staff is co-located with the Department of Food and Agriculture staff at the California border inspection stations for the detection and identification of property brought into California without payment of the sales and use tax. These continued efforts are expected to increase revenue by $6.35 million ($3.6 million General Fund) in both 2008-09 and 2009-10.

Action: Approved both consent / vote-only issues on a 2 - 0 vote, with Senator Kehoe absent.

Issues proposed for Discussion / Vote:

3. **Electronic Filing Expansion (BCP #1).** The Administration requests a 2008-09 augmentation of $4.7 million ($1.7 million General Fund), and 3.0 new positions to support expanded efforts in the area of electronic filing. This is a multi-year proposal and the anticipated 6-year cost is expected to be $16.5 million with a 6-year revenue benefit of $27.6 million. If the workload savings from e-filing is redirected to revenue positions, an additional revenue benefit of $40.3 million is projected.

   Background / Detail: This request includes five components:
   - Internet Registration – expand on-line registration to all tax and fee programs and allow tax and fee payers to enter business/personal information only one time for all permits/licenses required by the BOE.
   - E-Filing for Special Taxes – add e-filing for special taxes which will improve accuracy, audit selection, and efficiency.
   - E-Filing for Fuel retailers and Distributors – add e-filing for fuel taxes to speed reconciliation with associated sales tax payments and improved BOE efficiency.
   - On-line Requests for Extensions, etc. – add functionality to increase BOE efficiency by automating manual processes.
   - On-line Requests for Installment Payment Agreements – add functionally to increase BOE efficiency by automating manual processes.

   LAO Recommendation: In the *Analysis of the 2008-09 Budget Bill*, the Legislative Analyst does not raise any concerns with this specific BCP, but does recommend the BOE's budget be reduced by $1.4 million (General Fund) to account for anticipated e-file saving in 2008-09 that would result from past e-file initiatives.

   Staff Comment: The proposed budget already requests new positions to narrow the tax gap, so there should not be a benefit to redirecting existing e-file efficiencies to additional revenue activities in 2008-09. Staff understands the $1.4 million reduction ties to a BOE target for 2008-09.

   Staff Recommendation: Approve the BCP, but also reduce the BOE budget by $1.4 million (General Fund) to reflect anticipated e-file savings from past initiatives.

   Actions: Approved the BCP on a 2 – 1 vote with Senator Ackerman voting no. Approved the $1.4 million budget reduction in a separate motion on a 2 – 0 vote with Senator Kehoe absent.

4. **Tax Gap / Revenue Request (BCP #2).** The Administration requests an augmentation of $13.9 million ($9.0 million General Fund), and 136.5 new positions to support expanded efforts to narrow the tax gap and therefore collect more tax that is owed but not paid. The BOE estimates this proposal would result in additional revenues of $32.3 million ($20.0 million General Fund) in 2008-09 and $60.9 million ($38 million General Fund) in 2009-10.

Background / Detail: This request includes five tax gap initiatives:

- Bankruptcy / Out-of-State Collections – 5.0 positions and $545,000 ($354,000 General Fund) is requested to contract with FTB for bankruptcy data for out-of-state taxpayers, and additional BOE staff to speed the filing of tax liens and improve the State's lien priority for bankruptcy liquidation ($4.2 million [$2.6 million General Fund] revenue gain in both 2008-09 and 2009-10).
- In-State Service Businesses – 51.5 positions and $4.7 million ($3.1 million General Fund) is requested to increase compliance of use tax payment by service businesses inside the state that purchase goods outside the state ($13.6 million [$8.8 million General Fund] revenue gain in 2008-09 and $26.4 million [$16.0 million General Fund] in 2009-10).
- Collection Improvements – 14 positions and $1.3 million ($861,000 General Fund) is requested to increase audit activity ($2.9 million [$1.8 million General Fund] revenue gain in 2008-09 and $5.8 million [$3.7 million General Fund] in 2009-10).
- Audit Improvements – 63.0 positions and $7.0 million ($4.6 million General Fund) is requested to increase collection activity ($11.9 million [$7.6 million General Fund] revenue gain in 2008-09 and $24.6 million [$16.0 million General Fund] in 2009-10).
- Non-Filers and Tax Evadors Discovery Research – 3.0 positions (3-year limited term) and $351,000 is requested for research and survey work to develop procedures and leads to investigate, to narrow the tax gap for (1) internet sellers, (2) itinerant vendors, and (3) cash-based businesses. No revenue is scored for this effort, but BOE hopes this discovery research would result in future tax gap initiatives.

LAO Recommendation: In the *Analysis of the 2008-09 Budget Bill*, the Legislative Analyst makes several recommendations:

1. Score an additional $84,000 ($53,000 General Fund) in 2008-09 and $1.3 million ($0.8 million General Fund) in 2009-10 from an updated estimate of new revenues from the Bankruptcy component of this request.
2. Reject new funding for the Collection and Audit requests, and the field element of the In-State request, because they return only between $2 to $3 dollars in new revenue for every $1 spent.
3. Reject all but the internet-seller component of the Non-Filer request because the other components have a reduced chance of resulting in near-term revenue gains.

Staff Comment: The LAO recommendation #2 above would reduce budget costs

by about $9.4 million (about $6 million General Fund) in 2008-09 and by $17.0 million (about $11.1 million General fund) in 2009-10. However, anticipated revenue would also fall by $15.4 million (about $10 million General Fund) in 2008-09 and by $34.7 million (about $22.5 million General Fund) in 2009-10. Therefore, relative to the Administration's BOE proposal, there is net loss to the General Fund of about $6 million in 2008-09 and $11.4 million General Fund. While it may be good long-term policy to staff BOE only to the level of a $4 or $5 dollar benefit per dollar spent on collections and audit, the Subcommittee may want to consider lowering this threshold given this difficult budget. Over time, the number of taxpayers grows and e-filing efficiencies improve, so BOE staff can be reset in the future to achieve a higher benefit cost ratio if that is the best long-term policy.

Staff Recommendation: Approve the BCP, but score an additional $84,000 in 2008-09 revenue and reduce the Non-Filer component to just the internet-seller position as recommended by the LAO.

Action: Approved the LAO recommendation on a 2 – 0 vote with Senator Kehoe absent. In addition to the LAO recommendations listed above, the LAO recommendation also included an $884,000 reduction to the "In-State Services Business" component of the BCP request.

5. **Statewide Compliance & Outreach / Revenue Request (BCP #3).** The Administration requests an augmentation of $11.6 million ($7.5 million General Fund), and 112.0 three-year limited-term positions (including the extension of 32.8 existing limited-term positions) to identify and register entities that actively engage in business in California and sell tangible personal property without a seller's permit. The BOE estimates this proposal would result in additional revenues of $60.2 million ($37.9 million General Fund) in 2008-09 and $81.1 million ($51 million General Fund) in 2009-10.

Background / Detail: The BOE indicates this proposal will increase the number of permitted businesses operating in California by about 7,258 per year. Bringing businesses out of the underground economy levels the playing field for compliant businesses and reduces the tax gap.

Staff Comment: This proposal has a net General Fund benefit of $30.4 million in 2008-09, and benefit-to-cost ratio exceeding 5:1.

Staff Recommendation: Approve the request.

Action: Approved request on a 2 – 0 vote, with Senator Kehoe absent.

1730 Franchise Tax Board

The Franchise Tax Board (FTB) administers the personal income tax (PIT) program and the corporation tax (CT) programs. The FTB also administers the Homeowners' and Renters' Assistance Programs. The Department also performs some non-tax collection activities, such as the collection of child support payments and other court-ordered payments. The FTB is governed by a three-member board, consisting of the Director Finance the Chair of the Board of Equalization, and the State Controller. An executive officer, appointed by the Board, manages the daily functions of the Department.

The Governor proposes expenditures of $650 million ($554 million General Fund) and 5,348 positions for FTB – a decrease of $45 million (but a General Fund increase of $19 million) and an increase of 182.5 positions. The new positions are primarily associated with activities that will decrease the "tax gap," which is the $6.5 billion annual difference between taxes owed and taxes collected. The department estimates the requested tax-gap positions will increase General Fund revenues by over $90 million in 2008-09. Finally, the budget includes a minor adjustment to reflect a new voluntary contribution checkoff on tax returns – specifically, the California Sea Otter Fund (BCP 13), which was established by AB 2485 (Ch 296, St of 2006). The budget includes $6,000 from the California Sea Otter Fund to pay the FTB cost of administering the program.

Issues Proposed for Consent / Vote-Only

1. **Encoder Replacement (BCP #5).** The Administration requests a one-time augmentation of $1.2 million ($1.1 million General Fund) to replace three existing encoders. The existing encoders identify each check and money order, encodes it with the correct money amount, endorses it, and then sorts it to the correct bank. They have reached the manufacture's "end of life" and therefore face an increasing risk of failure. The new encoders will also be able to scan smaller documents (currently processed on large high-speed scanners) thus allowing FTB to scan tax returns and other larger documents more quickly and improve efficiency. If one of the existing encoders were to fail during a busy tax period, deposits could be delayed, resulting in a General Fund interest loss of up to $100,000 per day.

2. **Withhold at Source System (BCP #6).** The Administration requests $654,000 in 2008-09, and a five-year total of $7.3 million (all General Fund) for an information technology project to replace a system that processes non-wage withholding payments. Non-wage withholding includes real estate withholding and nonresident withholding for partnership distributions, independent contractors, and entertainers – these withholdings generate $2 billion in annual revenue. The existing system has limitations for exporting and importing data from other tax compliance systems, is vulnerable to unauthorized and undetectable access and manipulation, and provided limited standard management reports. The new system will address these deficiencies and generate an additional $7.8 million over the first five years of implementation – so this project will fully pay for itself over five years. The system will also provide taxpayers with new electronic filing options.

3. **California Child Support Automation System (BCP #15 and April Finance Letter)** The proposed budget includes $7.9 million (General Fund) and a decrease of $15.8 million in reimbursements to align the California Child Support Automation System (CCSAS) to the revised project documents. This information-technology project is managed by the FTB as an agent of the Department of Child Support Services (DCSS). The Department reports that in May 2007, the pilot counties for Version 2 were rolled out and the final county (Los Angeles) will be fully transitioned to the statewide system in November 2008. The April Finance Letter requests the shift of $44.5 million General fund and $44.1 in Reimbursement authority, as well as 146.0 positions to the Department of Child Support Services (DCSS) to affect the transfer of full responsibility for implementation of the CCSAS Project from FTB to DCSS. Since the Department of Child Support Services is in Subcommittee #3, staff will monitor that committee's actions related to CCSAS and bring any conforming changes to Subcommittee #4 as needed.

4. **Security Workload Growth (BCP #9).** The Administration requests an augmentation of $27,000 ($14,000 General Fund), a redirection of $440,000 (all General Fund) from E-File and E-Services savings, and 4.7 two-year limited-term positions (and deletion of 8.0 existing positions no longer needed because of E-File and E-Services), for securing FTB's critical assets and protecting confidentiality of taxpayer data. Of the 4.7 positions, 2.7 positions would address *inside* security threats such as inappropriate employee access or use of taxpayer information. The other two positions would address *external* security threats such as inappropriate vender activity or unauthorized access to FTB data and systems. Another consideration is that FTB must comply with Internal Revenue Service Security rules for federal information shared by the IRS – failure to adequately protect this data could result in the refusal of the IRS to provide the data, which would have a substantial negative impact on State revenue.

5. **Limited Liability Corporation – Court Decision (April Finance Letter).** The Administration requests $178,000 General Fund and 3.0 two-year limited-term positions to process the refunds of 4,000 claimants covering 10,000 tax years. The FTB was ordered by the California Court of Appeals to return a portion of the Limited Liability Corporation (LLC) fees paid by LLCs doing non reportable business in California.

6. **Court Ordered Debt Collection (BCP #7 & April Finance Letter).** The Administration requests $3.9 million (Court Collection Fund) and 56.5 positions (26.5 new positions, conversion of 12 limited-term positions to permanent, and 18 continuing limited-term positions) to continue the development and implementation of the Court Ordered Debt (COD) information technology project, and support the increase in collection program activities. The COD program has authority to collect delinquent court-imposed fines, penalties, forfeitures, and restitution orders. The April Finance Letter requests the addition of a budget bill provision to specify that the 15 percent limit on FTB administrative costs for court debt collection may be exceeded in 2008-09 due to the one-time costs of implementing the information technology project.

   Background / Detail: Since 1995, $320 million has been collected by FTB for the courts. Revenue collected supports county accounts, the State Restitution Fund, Victims-Witness Assistance fund, as well as the State General Fund. Collection activity has increased in recent years and this request supports the increased workload.

   Staff Recommendation: Approve the above requests.

Action: Approved all consent / vote-only issues on 2 – 0 vote, with Senator Kehoe absent.

Issues proposed for Discussion / Vote:

7. **Tax Gap – Base FTB Board Request (BCP #3).** The Administration requests an augmentation of $6.5 million (General Fund), and 68.5 new positions to support expanded efforts to narrow the tax gap and therefore collect more tax that is owed but not paid. The FTB estimates this proposal would result in additional General Fund revenues of $22 million in 2008-09 and $38.5 million in 2009-10.

   Background / Detail: This request includes three distinct tax gap initiatives:
   - Fraud Prevention and Detection – of the 32 positions and $2.4 million (General Fund) requested in this area, 18 positions would help reduce fraudulent use of the child and dependent care credit ($8.3 million General Fund savings in 2008-09 and $13.9 million in 2009-10), and the remaining 14 positions would help reduce fraudulent W-2 filings and reduce fraudulent refunds ($4.1 million General Fund savings in 2008-09 and $6.7 million in 2009-10).
   - Audit Workload Growth – 36.5 positions and $4.0 million (General Fund) are requested to bring staffing to the level to address all audit workload that statistically should produce an average benefit-to-cost ratio of 4:1 ($10.0 million General Fund revenue in 2008-09 and $20.0 million in 2009-10).
   - Compliance Behavior Study – $100,000 is requested for external consultants to measure the indirect effect, or change in taxpayer behavior, from FTB's various compliance activities.

   Staff Comment: The LAO raised some technical issues concerning the calculation of savings. The FTB revised the revenue estimate, and indicates that revenue in 2008-09 should be $300,000 higher in 2008-09 than the $22 million currently scored in the Governor's Budget from this BCP.

   Staff Recommendation: Approve the request, including the revised revenue estimate.

   Action: Approved request with revised revenue estimate on 2 – 0 vote, with Senator Kehoe absent.

8. **Tax Gap – Secondary Administration Request (BCP #14).** The Administration supplemented the Board-approved tax gap request in BCP #3, with additional initiatives that would increase the budget by $9.9 million (General Fund), and 138.7 new positions. The FTB estimates this proposal would result in additional General Fund revenues of $71 million in 2008-09 and $125 million in 2009-10.

   Background / Detail: This request includes five distinct tax gap initiatives:
   - New Data Source Pilot – 14.5 positions and $1.0 million (General Fund) are requested to better focus collection of unpaid tax debt by using Department of Motor Vehicles data on luxury auto registrations (cars with a value exceeding $40,000). This data should improve the ability of FTB to collect more of the

$7.3 billion in unpaid tax debt that has an "uncollectible status" ($27.0 million General Fund revenue in 2008-09 and $27.0 million in 2009-10).

- Vendor Contract / Administration for Non-Filer Mailing Addresses – 35.0 positions and $2.6 million (General Fund) are requested to purchase good/mailable addresses from vendors in order to send notices to non-filers with bad addresses. These contracts and associated FTB administration would allow the department to contact an additional 110,000 non-filers annually ($7.1 million General Fund revenue in 2008-09 and $23.0 million in 2009-10).
- IRS Information Return Master File (IRMF) – 26.2 positions and $2.1 million (General Fund) are requested for a $250,000 vendor contract and State staff to more effectively analyze and use federal IRMF data, which includes payer and payee interest, partnership / S Corporations, distributions, gambling winnings and miscellaneous other categories. FTB believes they can better mine this data to identify an additional 60,000 non-filers annually, and better focus collection efforts ($13.4 million General Fund revenue in 2008-09 and $46.8 million in 2009-10).
- Collection Program Workload – 60.0 positions and $4.1 million (General Fund) are requested to do additional collections activity. FTB indicates that position reductions in 2003-04 and the requirement to absorb certain price increases in 2005-06 and 2007-08 have reduced collection activity, which this request would restore ($18.5 million General Fund revenue in 2008-09 and $18.5 million in 2009-10).
- Mandatory E-Pay for PIT Payments over $20,000 – 3 positions and $161,000 (General Fund) are requested to implement a mandatory electronic payment of estimated tax installments that exceed $20,000 or with tax liabilities of $80,000 or more. This change would reduce deposit delays and increase the interest earnings of the State. FTB indicates that 1.8 percent of taxpayers would be affected, but those taxpayers pay over 50 percent of PIT revenues. New Jersey, Massachusetts, and Illinois currently have mandatory electronic payment requirements. ($5.0 million General Fund revenue in 2008-09 and $10.0 million in 2009-10).

Staff Comment: No issues have been raised with the reasonableness of the revenue estimates associated with these initiatives. The Administration did not submit trailer bill language associated with the last issue above (Mandatory E-Pay) and indicated their intent is to seek statutory change through a policy bill. The Subcommittee may want to separate the Mandatory E-Pay issue from the others, pending review of the necessary statutory language.

Staff Recommendation: Approve the request, except hold open the Mandatory E-Pay segment pending review of the necessary statutory language.

Action: Approved the request, except held open the Mandatory E-Pay component, on a 3 – 0 vote. The Chair requested that FTB provide additional information on taxpayer payment options and statutory language.

9. Tax Gap – Additional LAO Suggestions (also April Finance Letter). In the *Analysis of the 2008-09 Budget Bill*, the Legislative Analyst recommends additional tax gap measures the Legislature could take which would increase General Fund revenue. The Administration has adopted some of these recommendations in an April Finance Letter, and also suggested a new Tax Gap proposal. The LAO and Administration proposals combined would result in an augmentation of $3.3 million (General Fund), and 77.5 new positions. The FTB estimates these proposals would result in additional General Fund revenues of $37 million in 2008-09 and $53.9 million in 2009-10.

Background / Detail: This issue includes four distinct tax gap initiatives:

- IRS Revenue Agent's Reports (LAO and April FL) – 29.5 positions and $2.0 million (General Fund) are requested to analyses the growing number of IRS Revenue Agent's Reports (RARs), which detail additional federal tax liability from high-income individuals. The FTB receives these IRS reports, and generally, the federal audit finding of unpaid tax liability correlates with additional State liability. ($27.0 million General Fund revenue in 2008-09 and $38.4 million in 2009-10).

  Action: Approved on a 3 – 0 vote.

- Out-of-State Audit Workload (LAO only) – 10.0 positions and $500,000 (General Fund) are requested to perform additional audit activity for taxpayers located outside California, but who have California tax liability. (No General Fund revenue in 2008-09, $1.5 million in 2009-10, increasing to $10 million by 2011-12).

  Action: Approved on a 2 – 1 vote with Senator Ackerman voting no.

- Modify Group Income Tax Return Provisions (LAO only) –$100,000 (General Fund), and statutory change are recommended to increase the number of non-residents who are eligible for filing group tax returns, and thereby identifying current non-filers. Under current law, certain non-residents who receive income from a pass-through entity (partnerships or S corporations) that derives income from California sources, can elect to have the pass-through entity file a group nonresident return on their behalf. By expanding eligibility for group returns for non-residents with a tax liability exceeding $1.0 million, more non-residents who are not currently filing returns should begin to file via group returns. ($2.0 million General Fund revenue in 2008-09 and $6.0 million in 2009-10).

  Action: Approved on a 3 – 0 vote.

- Collection of Inactive Accounts Receivable (April FL only) – 9.0 positions and $576,000 (General Fund) are requested to increase collection efforts on outstanding accounts that have been placed in discharged status. (General Fund revenue gain of $8.0 million in 2008-09 and ongoing).

  Action: Approved on a 2 – 1 vote with Senator Ackerman voting no.

Staff Comment: The LAO revenue estimates in the *Analyses of the 2008-09 Budget Bill* have been further refined by FTB, but staff understands there is no dispute over the revised numbers discussed above.

Staff Recommendation: Approve the tax gap proposals presented in this issue for a General Fund revenue gain of $37 million in 2008-09.

8885 Commission on State Mandates

The Commission on State Mandates (Commission) is responsible for determining whether a new statute, executive order, or regulation contains a reimbursable State mandate on local governments and determining the appropriate reimbursement to local governments from a mandate claim. This budget item appropriates the funding for the staff and operations cost of the Commission, and appropriates non-Proposition-98 mandate payments to local governments.

The Governor proposes expenditures of $142.6 million ($140.7 million General Fund) and 12.0 positions (a decrease of 1.0 position). Included in these numbers, is a proposed 10-percent budget reduction of $168,000 and 1.0 position to the Commission's administration. The Budget also reflects the proposal, which was adopted in the Special Session, to discontinue the practice of paying *estimated* claims, and only pay claims once the full-year's cost has been incurred and filed with the State. This action reduced General Fund costs by $75 million in 2008-09 by shifting that cost to 2009-10.

Post Proposition 1A, the State is required to pay ongoing mandate claims and the budget includes $64.0 million General Fund for this purpose. Proposition 1A also requires the repayment of all pre-July 1, 2004, mandate claims over an unspecified number of years. The budget includes $75 million (General Fund) to pay a portion of the $900 million in outstanding pre-July 1, 2004 mandate claims.

Issues Proposed for Consent / Vote Only:

1. **Schedule Update for Two New Mandates (April Finance Letter).** The Administration requests amendments to the main mandate payment item in the budget bill to reflect the following two new mandates (1) DNA Database & Amendment to Post Mortem Exams: Unidentified Bodies (Ch. 822, St 2000; Ch 467, St 2001); and (2) Handicapped and Disabled Students II (Ch 1128, St of 1994; Ch 654, St 1996). No additional budget funding is needed for these mandates in 2008-09.

Staff Recommendation: Approve this request.

Action: Approved on a 3 – 0 vote.

Issues Proposed for Discussion:

2. **Budget Reduction to Commission Administration (Governor's Budget).** The Administration requests a 10 percent budget reduction ($168,000) to the Commission to help address the General Fund deficit. The Commission reports that it has made recent progress in reducing its mandate backlog by reducing the test claim workload from 102 claims to 68 claims between July 2006 and December 2007. A budget reduction of $168,000 and 1.0 position may slow the clearance of backlogs. Slowing progress on the backlog would delay determination and payment of new mandate claims, and to the extend mandate costs exceed expectations, and statutory change is required, it would also delay statutory amendments to change the mandate to reduce costs.

   Staff Comment: The Subcommittee may want to hear from the Commission on the cost risks to the State associated with the proposed budget reduction. If the reduction is approved, the Subcommittee may want to revisit Commission staffing in a future year and make budget adjustments if warranted.

   Staff Recommendation: Approve the proposed budget reduction.

   Action: Approved on a 3 – 0 vote.

9100 Tax Relief

The 9100 budget item includes several programs that provide property tax relief by: (1) making payments to individuals to partially offset their property tax payment (or rent in the case of renter), and (2) making payments to local governments to help defray revenues lost as a result of tax relief programs. There are five tax relief programs in this item, and the funding amount indicated is the amount budgeted (all General Fund) prior to proposed budget reductions:

- Senior Citizens' Property Tax Assistance ($40.6 million)
- Senior Citizens' Property Tax Deferral Program ($25.8 million)
- Senior Citizen Renters' Tax Assistance Program ($150.3 million)
- Homeowners' Property Tax Relief ($442.5 million)
- Subventions for Open Space / Williamson Act ($38.6 million)

The Homeowners' Property Tax Relief program is constitutionally required, and therefore it is excluded from the 10-percent cut proposals. The Governor proposes that the remaining four programs each receive a 10-percent budget cut to save $25.5 million (General Fund). The proposed cuts to homeowners/renters programs are outlined in issue #1, and the proposed cuts to the Williamson Act program is discussed in issue #2.

Issues Proposed for Discussion:

1. **Homeowners/Renters Programs (Governor's Budget).** The Administration requests a 10-percent budget reduction ($21.6 million) to the three homeowners/renters tax relief programs. The reductions are proposed as proportional cuts, so each recipient would see their payment fall by 10 percent.

   Background / Detail: The three programs included in this issue are as follows:
   - Senior Citizens' Property Tax Assistance – provides income-based payments to homeowners with household incomes below $42,770 who are over 62, disabled, or blind. The maximum annual grant is currently $473. The proposed 10-percent would result in General Fund savings of $4.1 million.
   - Senior Citizens' Property Tax Deferral Program – allows homeowners with annual household incomes below $35,500, and who are at least 62 years old, blind, or disabled, to postpone their property tax payments. The state makes the property tax payments on the homeowners' behalf, and is reimbursed when the home is sold, or the qualifying occupants cease their residency. The proposed 10-percent would result in General Fund savings of $2.6 million.
   - Senior Citizen Renters' Tax Assistance Program - provides income-based payments to renters with household incomes below $42,770 who are over 62, disabled, or blind. The maximum annual grant is currently $348. The proposed 10-percent would result in General Fund savings of $15.0 million.

   LAO Comment / Alternative: In the *Analysis of the 2008-09 Budget Bill*, the Legislative Analyst recommends rejection of the Governor's 10-percent across-the-board approach and instead recommends an alternative that results in similar budget savings, but shifts the impacts away from the lowest-income taxpayers. To

illustrate their criticism of the Governor's proposal, the LAO indicates that under the Administration plan the average homeowner with an income of $40,000 would see his or her payment reduced by $2, but a renter with an income of $10,000 would have his or her payment reduced by $35. The LAO recommends that the Renters' Program and Property Tax Deferral Programs be left whole, and instead the Property Tax Assistance program income limits be rolled back from $42,800 to $33,000. This would result in savings of $18.5 million (versus the $21.6 million in the Governor's Proposal).

Staff Comment: If the Legislature determines that cuts in this area of the magnitude of $20 million are necessary, the LAO's approach appears to be preferable to the Administrations. However, the Subcommittee may want to hold action at this time to consider the relative merits of tax relief in this area (budget expenditures) versus tax relief in the area of tax expenditures. While the Administration has drawn a distinction between tax relief grant programs (such as these programs) and tax relief via tax expenditures that reduce tax payments, the end result to the taxpayer is not dissimilar.

Staff Recommendation: Keep open for further analysis.

Action: Held open to further consider in the context of overall tax relief and State/ local fiscal issues.

2. **Subventions for Open Space / Williamson Act (Governor's Budget).** The Administration requests a 10-percent budget reduction ($3.9 million) to Williamson Act grants. The Williamson Act allows cities and counties to enter into contracts with landowners to restrict certain property to open space and agricultural uses. In return for these restrictions, the property owners pay reduced property taxes because the land is assessed at the lower-than-maximum level. The State then *partially* compensates the local governments for their related property tax loss. The Administration reduction proposal would lower payments to cities and counties, but would not restrict new Williamson Act contracts between property owners and local governments.

   LAO Comment / Alternative: In the *Analysis of the 2008-09 Budget Bill*, the Legislative Analyst recommends approval of the 10 percent reduction proposed by the Governor, but also that the program be phased out by not allowing any new contracts. Budget savings would increase annually as contracts expire until the program is fully phased out in 10 years. The LAO indicates that the Williamson Act is not a cost-effective land conservation program because in many cases it subsidizes landowners for behavior they would have taken regardless.

   Staff Recommendation: Keep open to consider this reduction in the context of other requested reductions in the local government area.

Action: Held open to further consider in the context of overall State/local fiscal issues.

9210 Local Government Financing

The 9210 budget item includes a variety of State General Fund subventions to local governments for general or specific activities. Some of the larger subventions are listed below, and the funding amount indicated is the amount budgeted (all General Fund) prior to proposed budget reductions: :

- Small and Rural Sheriffs Grant Program ($18.5 million)
- Citizens' Option for Public Safety / Juvenile Justice Crime Prevention ($238 million)
- Booking Fees ($35 million)
- Disaster Property Tax Relief ($877,000)
- Redevelopment Agency Special Subventions ($800,000)

The Governor proposes a 10-percent budget cut to all of these programs to save $29.4 million (General Fund), and reduce spending in this budget item from $293.2 million to $263.7 million. The proposed cuts to the law-enforcement / juvenile justice programs are not covered in this agenda, because they will be grouped with other law enforcement budget topics when those issues are discussed at a subsequent hearing.

Issues Proposed for Discussion:

1. **Disaster Property Tax Relief (Governor's Budget).** This budget item funds tax relief to homeowners and local governments impacted by specified natural disasters. For example, SB 38 (Ch 22, St of 2007) provide specified property tax relief to individuals and local governments for property damage caused by wildfires in Riverside County. The Governor proposes a 10-percent reduction in this item for savings of $88,000.

   Staff Comment: The Administration indicates that this reduction would not impact any property owners or local governments, because they would still be entitled to related benefits even in excess of the appropriated amount. In recent years a significant amount of the budget Act appropriation for similar legislation has been unclaimed, and reverted to the General Fund as savings. So this proposed reduction does not really cut a program, it just scores an anticipated savings that would revert on its own if realized.

   Staff Recommendation: Keep open to consider this reduction in the context of other requested reductions in the local government area.

   Action: Held open to further consider in the context of overall State/local fiscal issues.

2. **Redevelopment Agency Special Subventions (Governor's Budget).** This budget item funds State subventions to Redevelopment Agencies to backfill revenues they lost in the 1980s. These redevelopment subventions were instituted after the State eliminated personal property tax supplemental subventions to redevelopment agencies. The current subventions were intended to ensure that redevelopment agencies would not default on bonds that had been backed with personal property tax subvention revenue. The funds are only provided to RDAs that were in existence when the tax was eliminated, and only is provided to those RDAs that need the funds to cover bond indebtedness costs. The Governor proposes a 10-percent reduction in this item for savings of $80,000.

   Staff Comment: This subvention was instituted about 20 years ago and since then property tax revenues has grown significantly and Proposition 1A was approved to better define State and local revenue. In light of these events, and the current General Fund situation, the Administration should be prepared to discuss whether it would create an undue hardship on redevelopment agencies to completely eliminate this subvention and have affected redevelopment agencies absorb a $800,000 reduction.

   Staff Recommendation: Keep open to consider this reduction in the context of other requested reductions in the local government area.

   Action: Held open to further consider in the context of overall State/local fiscal issues.

9350 Shared Revenues

The 9350 budget item apportions special monies collected by the State to local governments on the basis of statutory formulas. Of the amounts displayed in this budget item, $12.3 million is General Fund and $2.1 billion is special funds and federal funds. As indicated, the apportionments are generally statutory, and this year, there is no budget bill appropriation for this budget. However, the Administration proposes trailer bill language to implement 10-percent budget reductions for the two General Fund apportionments.

Issues Proposed for Discussion:

1. **Trailer Vehicle License Fee (Governor's Budget).** This budget item apportions revenue to cities and counties that lost Vehicle License Fee (VLF) revenue when the State converted from an un-laden weight system to a gross vehicle weight system for purposes of assessing VLF for commercial vehicles. This change conforms with the International Registration Plan, a reciprocity agreement among US states and Canada for payment of commercial license fees based on distance operated in each jurisdiction. This funding is deposited in the Local Revenue Fund to support local health and welfare programs. The Governor proposes a $1.2 million cut (10 percent) to this $11.9 million backfill apportionment.

   Staff Comment: This apportionment was instituted before, and is separate from, the VLF Swap that shifted property tax to cities and counties to backfill for the VLF rate reduction. Proposition 1A has since been approved to better define and stabilize State and local revenue. At least in the short term, local governments have benefited from the VLF Swap because property taxes have grown at a faster rate than vehicle license fees. According to Department of Finance estimates, cities and counties will receive approximately $6.1 billion in VLF Swap property taxes in 2008-09; however, if the VLF was still set at the historic 2-percent rate, they would only get about $5.0 billion. The VLF Swap is protected by Proposition 1A restrictions, but the trailer fee backfill is not constitutionally protected.

   In light of the General Fund budget condition, and revenue benefit cities have received from the VLF Swap, the Subcommittee may want to consider eliminating this Trailer VLF backfill to save the General Fund $11.9 million.

   Staff Recommendation: Keep open to consider this reduction in the context of other requested reductions in the local government area.

   Action: Held open to further consider in the context of overall State/local fiscal issues.

2. **Tideland Oil Revenue (Governor's Budget).** This budget item apportions 1 percent of revenue received by the State from leases of publicly owned coastal waters for oil extraction, to local governments in whose jurisdiction the extractions are occurring. Statute requires that the amounts paid to cities and counties shall be deposited in a special tide and submerged lands fund to be held in trust and to be expended only for the promotion and accommodation of commerce, navigation, and fisheries, for the protection of lands within the boundaries of the cities and counties, for the promotion, accommodation, establishment, improvement, operation, and maintenance of public recreational beaches and coastlines, and the mitigation of any adverse environmental impact caused by exploration for hydrocarbons. The Governor proposes a $46,000 cut (10 percent) to this $462,000 apportionment.

   Staff Comment: This apportionment provides compensation to local communities that may be impacted from State leases of offshore waters for oil extraction.

   Staff Recommendation: Keep open to consider this reduction in the context of other requested reductions in the local government area.

   Action: Held open to further consider in the context of overall State/local fiscal issues.

Control Section 31.00 - Administrative Procedures for Salaries and Wages

Control Section 31.00 specifies Department of Finance oversight responsibilities concerning salaries and wages, and the establishment of positions. The control section also establishes notification requirements for the Administration to report to the Legislature when positions are administratively established and when a position is re-classed to a position with a minimum salary step exceeding $6,808 per month. Similar language was approved by the Legislature with the 2007 Budget Act.

Staff Comment: The LAO has suggested some amendments to the language to streamline the document requirements of the control section. Staff understands there is no objection to these amendments. The revised language is as follows:

> *c) The Department of Finance shall, for a period of not less than two years, keep and preserve documentation concerning (1) the authorization of any position not authorized for that fiscal year by the Legislature and (2) any reclassification to a position with a minimum step per month of $6,808, which is equivalent to the top step of the Staff Services Manager II (Managerial) classification as of July 1, 2008. The department may use electronic means to keep and preserve this documentation.*

Staff Recommendation: Approve the control section with the revised language.

Action: Approved revised language on a 3 – 0 vote.

Control Section 32.00 Prohibits Excess Expenditures

Control Section 32.00 of the budget bill prohibits expenditures in excess of appropriations, except for specified health and safety situations, and when specified legislative notification has been provided. The language specifies the department directors may be held personally liable for any indebtedness beyond the appropriated level and when no specified exception applies. This language proposed this year includes a new subsection that removes personal liability for any amount of indebtedness related to 10-percent budget reductions as contained in Control Section 4.44.

Staff Comment: The Administration proposed a similar amendment to the 2007 Budget Act Control Section 32.00 in the Special Session, and this amendment was rejected by the Legislature. Additionally, the Department of Finance submitted a Finance Letter dated March 25, 2008, that deleted Control Section 4.44.

Staff Recommendation: Conform to the Special Session action and delete the Administration's amendments to Control Section 32.00 that remove personal liability for excess expenditures involving reductions in Control Section 4.44.

Action: Conform to Special Session action on a 3 – 0 vote.