Summary of Recommended Legislation

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Table of Contents

Introduction 1

Judicial

Judicial
Coordination of Civil Proceedings 3

Executive

Department of Justice
Reimbursement for Legal Work Performed by the State for Counties in Conflict-of-Interest Cases 5

State and Consumer Services

Department of Consumer Affairs
- Special Fund Reserve Ceiling 7

Department of General Services
- Legislative Review of Leases 11
- Appointment of the State Architect 13
- Real Property Asset Management Program 15
- Review of Energy Efficiency Revenue Bonds 17

State Personnel Board
- Board Members' Compensation 19

Business, Transportation and Housing

California Highway Patrol
- Helicopter Expenditures 21

Department of Transportation
- Abandoned Railroad Right-of-Way Acquisition Program 23

Mandated Local Costs
- Disabled Motorist Assistance Program 25

Resources

California Coastal Commission
- Coastal Development Permit Fees 27

Department of Food and Agriculture
- Export Promotion Program 29

Department of Forestry and Fire Protection
- Timber Harvest Permit Fees 31

Department of Water Resources
- Safe Drinking Water Bond Program Improvements 33

Revenue and Taxation CONTINUED

Senior Citizens' Property Tax Deferral
Fees for Certificates of Eligibility 81

Capital Outlay

State Public Works Board
Augmentation Authority 83
Control of Project Augmentations--
Various Special Funds 85
Statewide Capital Outlay Master Plan 87

Resources CONTINUED

State Assistance Fund for Energy, California Business and Industrial Development Corporation (SAFE-BIDCO)
Elimination of Program 35

State Water Resources Control Board
Leaking Underground Tanks Oversight Fees 37

Health and Welfare

Commission on State Finance
Update of the California Necessities Index 39

Department of Health Services
Clinical Laboratory Inspection and Enforcement 41
Regulation of Small Water Systems 45

Department of Social Services
Independent Adoption Fees... 51

K-12 Education

Department of Education
Continuation High School Funding 55
Implementation of Proposition 98 57
School Facilities Guaranteed Yield Funding Formula 59
School Facilities Funding Allocation Formula 61

Mandated Local Costs
Certification of Teacher Evaluators 63

Postsecondary Education

California Community Colleges
Health Services Fee 65

General Government

Commission on State Mandates
Funding for State-Mandated Local Programs 67

Office of Criminal Justice Planning
Allocation of Penalty Assessments 69

Public Utilities Commission
Regulation of the Trucking Industry.............................. 71

Revenue and Taxation

Personal Income Tax
Depreciation Rules for Residential Rental Housing 73

Property Tax
Partial Exemption for Wildlife Habitat Lands 75

Sales and Use Tax
Exemption for Coins and Gold and Silver Bullion 77
Exemption for Packing Ice and Dry Ice Used to Ship Food 79

Introduction

This report presents recommendations for legislation based on our reviews of state programs. In order to meet legislative deadlines for bill introduction, this report includes recommendations based on our analysis of the 1989-90 Budget, as well as recommendations we have previously made in other publications which we continue to believe are viable for legislative consideration.

This report (1) summarizes our analysis of the issues at stake, (2) outlines the changes in existing law that we recommend, and (3) presents our estimate of the fiscal effect from the proposed legislation. These recommendations generally fall into one of the following categories:

- Legislative changes to enhance the Legislature's oversight of state expenditures.
- Legislative changes to permit recovery of program costs--in whole or in part--through fees, assessments and fines.
- Legislative changes to enhance the ability of the state to generate revenues.
- Legislative changes to allow the state to "stretch" its limited resources.
- Legislative changes which would improve services provided to the citizens of California and probably would result in direct savings to the state.

In a separate report entitled *Federal Welfare Reform in California,* issued earlier this month, we make several recommendations for enactment of legislation in order to comply with the new federal welfare requirements. Those recommendations are not repeated in this report.

Judicial
Coordination of Civil Proceedings

Recommendation

We recommend the enactment of legislation requiring the counties involved in coordinated civil action proceedings to pay a share of the costs of this program.

Fiscal Impact

Annual General Fund savings of up to $725,000, depending on the number of coordinated proceedings each year and the distribution of costs between the state and counties. Corresponding costs to counties involved in such proceedings.

Analysis

State law provides a mechanism by which suits on related matters, but in different courts, can be coordinated. The purpose of the mechanism is to eliminate unnecessary duplication in civil court proceedings. Under state law, a litigant or the judge in a case can require the Judicial Council to appoint a "coordination motion judge" who will determine whether an action should be coordinated with related actions. If this judge decides to coordinate the actions, the Judicial Council must then appoint a "coordination trial judge" to hear and resolve the coordinated action. For example, a number of cases dealing with asbestos insurance issues were coordinated and are currently being heard by one judge in the San Francisco Superior Court.

The costs of this program are proposed at $725,000 for 1989-90. This includes $100,000 for the council's administrative costs of supervising the coordination activities which the state is required to pay. In addition, the state is required to pay the costs incurred by the court in which the proceeding is heard. The Judicial Council estimates that these costs will total $625,000 in the budget year.

The primary beneficiaries of the coordinated proceedings program are the counties. This is because the program reduces the number of separate actions that must be handled by the courts, thereby reducing court workload. While it is unlikely that counties incur direct savings as a result of the program, they benefit because the courts can handle other workload

Analysis CONTINUED

increases without additional resources. The state also may benefit from the program to the extent that it reduces the number of conflicting lower court rulings which are resolved by the courts of appeal. The courts of appeal are supported from the General Fund.

We are concerned that the current distribution of responsibility for funding this program does not reflect the distribution of benefits it produces. Under existing law, the counties realize most of the benefits from the program, while the state incurs the full cost. Accordingly, we recommend that legislation be enacted requiring the counties involved in a coordinated action to pay a share of the total costs of the coordination program.

Reference

1984-85 *Analysis*, page 17. ❖

Department of Justice
Reimbursement for Legal Work Performed by the State for Counties in Conflict-of-Interest Cases

Recommendation

We recommend the enactment of legislation to require that counties reimburse the state for legal work performed by the Attorney General on behalf of district attorneys who are disqualified from handling local cases due to conflicts of interest.

Fiscal Impact

Potentially more than $1 million in annual General Fund revenues, depending on the actual statutory changes adopted.

Analysis

Under California law, district attorneys are responsible for prosecuting persons who commit public offenses. However, there are several circumstances in which the state Attorney General takes over prosecutorial responsibilities for counties. In some of these situations, the counties reimburse the Attorney General for these legal services, while in other cases they do not. For example, the Attorney General is not reimbursed for legal services it provides when the district attorney is disqualified from prosecuting criminal cases within the county. Generally, district attorneys are disqualified from prosecuting criminal cases because of conflicts of interest (for example, when an employee in the district attorney's office is charged with a crime).

According to the Department of Justice, over a three-year period, it incurred General Fund costs of approximately $4.5 million to perform legal work in conflict-of-interest cases. This amount includes $1.4 million in 1984-85, $1.3 million in 1985-86, and $1.8 million in 1986-87.

Based on our review, we conclude that there are inconsistencies in the present system for paying prosecution costs. Specifically, while the state may recover its costs from counties for certain legal work it performs on their behalf, the state must pay for legal work that it performs for counties in conflict-of-interest cases. Moreover, it is unclear why the state should bear the cost of prosecuting a district attorney's office employee who is accused of a crime,

Analysis CONTINUED

while the county would bear the costs of prosecuting an employee of any other county office or any other person convicted of a crime in the county.

Accordingly, we recommend the enactment of legislation requiring counties to reimburse the state for all or a portion of the legal work it performs in conflict-of-interest cases, as they do for other legal work performed by the state on their behalf. Based on recent trends, this recommendation could result in a General Fund savings of more than $1 million annually, depending on the actual statutory changes adopted.

Reference

1988-89 *Analysis*, page 53. ❖

Department of Consumer Affairs
Special Fund Reserve Ceiling

Recommendation

We recommend enactment of legislation to lower the statutory fund reserve ceiling *to an amount equal to: (1) one year of operating expenses for small agencies within the Department of Consumer Affairs which have annual operating expenses of $1 million or less and (2) six months of operating expenses for agencies with annual operating expenses exceeding $1 million. We further recommend the enactment of legislation to authorize all boards and commissions to renew licenses biennially on a continuous basis to allow agencies to comply with the statutory reserve ceiling.*

Fiscal Impact

Potential decrease in fees paid by licensees of the regulatory boards and bureaus within the Department of Consumer Affairs.

Analysis

The Department of Consumer Affairs (DCA) consists of 40 occupational regulatory agencies including boards, bureaus and commissions. Each agency is supported by license and regulatory fee revenues.

Current law prohibits these agencies from having unencumbered reserves at the end of any fiscal year which exceed the agency's operating budget for the next *two* fiscal years. (For instance, the reserve at the end of 1989-90 cannot exceed the operating costs for 1990-91 and 1991-92.) Otherwise, the agency must reduce its fees in order to comply with this requirement. Our review indicates that, while few agencies maintain reserves exceeding the statutory ceiling, many have reserves that exceed *one* year of operating expenses. For instance, 16 of the 40 agencies are projected to have a reserve at the end of 1989-90 that exceeds one year of operating costs.

Reserve Amounts Can Be Less. Our analysis, however, indicates that agencies do not need to maintain such a sizeable reserve in order to cover various contingencies. For instance, of the 127 deficiency requests approved or pending approval from 1983-84 through 1988-89, 82 percent were for amounts equal to 10 percent or less (approximately two months) of the agency's operating costs for that year. No request exceeded two-thirds of an agency's annual operating costs. In addition, a majority of the deficiencies which exceeded 10 percent of operating costs were requested by small agencies with annual expenditures of $1 million or less.

Based on this experience, therefore, it appears that a reserve ceiling of one year would provide sufficient flexibility to cover funding deficiencies of the smaller agencies. For agencies with annual expenditures that exceed $1 million, our review shows that a reserve ceiling of six months of operating costs appears adequate and prudent.

Reserves of these magnitudes also should provide adequate funds for annual cost and salary increases for these agencies. To the extent that program changes are proposed which would result in a significant increase in agencies' expenditures, plans to increase fees to support the increased costs should be included in the budgetary proposal.

License Renewal Dates Should be Changed to Provide Even Revenue Flow. Currently, five agencies collect most of their fee revenues on a specific date every two years. As a result, these agencies must maintain a large reserve sufficient to cover expenses over a two-year period. These agencies are the Boards of Barber Examiners, Registration for Geologists and Geophysicists, and Examiners of Nursing Home Administrators, the Speech Pathology and Audiology Examining Committee, and the Registered Dispensing Opticians program within the Board of Medical Quality Assurance.

A change in the license renewal cycle to one which renews licenses biennially on a continuous basis (such as according to licensee birth dates) would provide a more even revenue flow into the accounts, and would therefore reduce the need for a high account reserve. A change in the license renewal cycle also would even out the agencies' workload throughout the year.

Recommendation. Based on our review, agencies in the DCA do not need to maintain up to two years of operating expenses in reserve to meet various funding contingencies. Consequently, we recommend that legislation be enacted to lower the reserve *ceiling* to two different levels, depending on agency size: (1) an amount equal to one year of operating expenses for small agencies with annual operating expenses of $1 million or less and (2) six months for agencies with annual operating expenses exceeding $1 million. We further recommend that legislation be enacted to authorize all agencies to renew licenses biennially on a continuous basis to allow these agencies to comply with the statutory reserve ceiling. ❖

Department of General Services
Legislative Review of Leases

Recommendation

We recommend the enactment of legislation revising current provisions for legislative review of leases for state space needs.

Fiscal Impact

Unknown potential savings to the General Fund and other state funds depending on leasing activities. Provides legislative oversight over all proposed leases with an annual cost of $100,000 or more.

Analysis

State law requires the Department of General Services (DGS) to notify the Joint Legislative Budget Committee and the fiscal committees at least 30 days prior to entering into leases which involve (1) annual rental payments exceeding $10,000 *and* (2) a firm lease period of five years or longer. (The DGS acts as the state's agent for most lease transactions.) The Legislature is provided such advance notification because lease signings often obligate the state to significant expenditures. Moreover, due to the nature of leasing activities and lease rental payment schedules, leases often are signed well in advance of the requests for budget augmentations that are needed for rental payments.

The present criteria for notification, however, do not effectively serve the Legislature's interests. The dollar threshold of $10,000 is relatively low. On the other hand, the five-year firm term criterion results in the Legislature not receiving notification on leases with significant fiscal effect.

For example, DGS recently entered into three leases for office space for the Franchise Tax Board. These leases will increase the board's General Fund budget for rent by $225,000 in 1988-89 and $480,000 in 1989-90. In each case, the firm term of the leases is 50 months (10 months less than the reporting threshold). Consequently, the Legislature was not notified of these lease proposals even though the annual cost increase is substantial. In fact, the Department of Finance recently notified the Legislature of its intent to request a $7 million General Fund deficiency appropriation for the board. This deficiency request includes $225,000 to pay the current-year cost of these signed lease agreements. Thus, for all practical purposes the Legislature is left with no option other than to approve this portion of the deficiency, as well as $480,000 in increased costs in the budget year.

We believe the Legislature should have the opportunity to review leases with potentially significant fiscal effects, prior to the obligation of state funds. Therefore, we recommend enactment of legislation revising the reporting threshold for legislative review to those proposed leases with an annual cost of $100,000 (in any year within the lease term), without regard to the firm term period. In the case of lease renewals or extensions, legislative review should be limited to circumstances where the annual lease cost would *increase* by $100,000 or more in any year within the new lease term.

In addition, the notifications should be sent to the Legislature by the Director of the Department of Finance, rather than by DGS. These leases represent significant increases to the state budget. Once lease agreements are signed, the expenditure of the funds, for all practical purposes, is required. In view of this fiscal implication, the leases should be reviewed, approved and sent to the Legislature by the Director of the Department of Finance. ❖

Department of General Services
Appointment of the State Architect

Recommendation

We recommend the repeal of Government Code Section 14950, which requires the Governor to appoint the State Architect.

Fiscal Impact

None.

Analysis

In 1986-87, the Department of General Services established the Office of Project Development and Management (OPDM). This office was established partly in response to legislative concerns with poor management of the state's capital outlay program by the Office of the State Architect (OSA). The OPDM was to be responsible for ensuring that all phases of project design and construction were completed on time and within the budget approved by the Legislature. Despite legislative intent and administrative action, however, OSA continues to exercise substantial control over the state's capital outlay program managed by the Department of General Services.

In order for OPDM to effectively manage the state's capital outlay program, it is essential that OPDM have the same control over OSA as it has over private-sector providers of architectural and engineering services. While private consultants are accountable to OPDM for the timeliness and quality of their work, OSA is not. As long as the State Architect remains a Governor's appointee, however, it will be difficult for the Director of General Services, another Governor's appointee, and the Director of OPDM, a Career Executive Assignment (CEA) position, to effectively establish this accountability. Therefore, we recommend that the Legislature remove this difficulty by making the State Architect a position appointed by the Director of General Services. If the Legislature takes this action, it should also repeal Government Code Section 11554(c), which sets the salary of the State Architect as a Governor's appointee. ❖

Department of General Services
Real Property Asset Management Program

Recommendation

We recommend the enactment of legislation establishing, within the Department of General Services, a real property asset management program.

Fiscal Impact

Up to $700,000 annual cost to the Property Acquisition Law Account in the General Fund beginning in 1990-91. Potentially major revenues (exceeding $10 million annually) to the General Fund and other state funds beginning in 1993-94.

Analysis

In prior legislation, the Legislature has directed the Department of General Services (DGS) to take initial steps to improve its management of under-utilized and surplus state properties. For example, Chapter 907, Statutes of 1986, required DGS to develop a computerized inventory of state real property by January 1989. This inventory is an essential tool for any endeavor to more aggressively identify and manage under-utilized and surplus properties. According to DGS, it will complete development of the inventory by January 1990.

In addition, Chapter 444, Statutes of 1986, funded a pilot project to identify under-utilized and surplus properties in a geographic area to be determined by DGS. (The DGS selected the City of San Diego and surrounding communities to participate in the pilot.) The legislation required that a consultant study the potential for generating revenue from these properties, and submit to the Legislature a report with findings and recommendations for establishing a "proactive" assets management program. Such a program would actively seek to lease state properties which currently are not leased. That report, submitted to the Legislature in July 1988, concluded that such a program was both feasible and capable of increasing state revenues significantly. According to the report, proactive management of three under-utilized state properties identified in the project area could generate between $4.8 million and $10.8 million annually in lease revenues.

We agree with the report's general assessment that a proactive assets management program would be cost-beneficial. The Governor's 1989-90 Budget includes $696,000 from the Property Acquisition Law

Account in the General Fund for the start-up of such a program. We believe, however, that enabling legislation is needed in order to establish such a program. Therefore, we recommend enactment of legislation establishing within DGS a Proactive Asset Management Program. The legislation should provide for the deposit of net proceeds from property leasing into the General Fund to conform with the current treatment of net proceeds from property sales. In addition, the legislation should require DGS to integrate its plan for asset management, identifying the proposed use and disposition of each property, into its annual report on surplus state property. The Legislature could consider the plan during its deliberations on the annual surplus property bill. ❖

Department of General Services
Review of Energy Efficiency Revenue Bonds

Recommendation

We recommend the enactment of legislation to revise the process for reviewing energy revenue bond projects in order to strengthen legislative oversight and control of the Energy Efficiency Revenue Bond Program.

Fiscal Impact

Unknown fiscal impact depending on proposed energy conservation measures. Provides improved legislative oversight and control of the expenditures of nearly $500 million in bond funds.

Analysis

The Energy Efficiency Revenue Bond Program was created to finance energy projects undertaken by state departments. Under this program, the State Public Works Board (PWB) is authorized to issue, over a 10-year period, up to $500 million in revenue bonds to finance such projects. The bonds are to be repaid from the savings which result from the energy improvements. Any savings in excess of the amount needed to repay the bonds are shared, on a 50-50 basis, by the department undertaking the energy improvement and the General Fund.

State law requires the administration to notify the Joint Legislative Budget Committee and the fiscal committees of the need for energy project contracts at least 30 days prior to their approval by the PWB. This process allows the Legislature to review and comment on proposed expenditures of the revenue bonds. The Legislature has an interest in reviewing these expenditures because if energy projects fail to generate anticipated savings the only choices available to the Legislature are (1) appropriating funds to pay back the bonds or (2) allowing departments to absorb bond payments in existing support budgets--a course that could have significant program impacts.

On a number of occasions during 1986 and 1987, the Chair of the Joint Legislative Budget Committee expressed concerns to the Director of General Services on energy projects which were the subject of notifications to the Legislature. On these occasions, the Chair requested that the administration either (1) defer action on projects pending further information, (2) reduce project costs, or (3) not proceed with the proposed projects. In several of these instances, the department and PWB proceeded with the project despite the Chair's request.

In our view, the Legislature should have a greater opportunity to review the energy revenue bond program which, under existing authority, could involve the expenditure of almost $500 million of state funds over the next 10 years. Currently, the Legislature does have the opportunity to review the administration's proposals for energy conservation projects funded through capital outlay budgets. Specifically, the Legislature reviews projects and proposed expenditures *before* it appropriates funds. However, it does not have that opportunity under the current process for energy revenue bonds, even though it has precisely the same interest in ensuring that funds are spent on the best possible projects. There is no intrinsic difference between energy projects funded through capital outlay budgets or the revenue bond program, nor is there any difference in the financial risk assumed by the state under either funding mechanism. Thus, in our view, there should be no difference in the process by which they are reviewed.

Accordingly, we recommend that the Legislature enact legislation to generally revise the process for review of projects funded under the Energy Efficiency Revenue Bond Program. This revision should include the following key elements: (1) rescission of the current continuous appropriation authority for energy revenue bonds and (2) a requirement that the annual Governor's Budget delineate the projects proposed for energy revenue bond funding in the coming year.

Reference

1988-89 *Analysis*, page 134. ❖

State Personnel Board
Board Members' Compensation

Recommendation

We recommend the enactment of legislation to pay board members a per diem, rather than a set salary.

Fiscal Impact

Annual savings to the General Fund of approximately $147,000.

Analysis

The State Personnel Board (SPB) is a constitutional body consisting of five members appointed by the Governor for 10-year terms. The board has authority under the State Constitution and various statutes to adopt state civil service rules and regulations.

Each of the five board members currently receives an annual salary of $25,118. Related staff benefits bring total state costs for the five board members to approximately $161,000 per year. In recent years, the board's responsibilities have decreased significantly, due to: (1) the transfer of authority for salary setting, personnel administration, and classification to the Department of Personnel Administration, and (2) the advent of collective bargaining. At present, the board usually meets two or three times a month to hear employee appeals and other personnel matters.

Many other state boards and commissions (such as the Public Employees' Retirement System Board of Administration) pay their members per diem, in lieu of a salary. Because there is no significant distinction between the demands placed on members of the SPB and those placed on other part-time boards, we recommend that legislation be enacted providing SPB members with a $100 per diem plus necessary expenses, in lieu of a salary. Based on the number of meetings held by the board, the annual per diem costs would be about $14,000 resulting in a net General Fund savings of approximately $147,000 per year.

Reference

1987-88 *Analysis*, page 177. ❖

Department of the California Highway Patrol
Helicopter Expenditures

Recommendation

We recommend enactment of legislation requiring local and federal governmental entities utilizing the California Highway Patrol's (CHP) helicopter services to reimburse the patrol for its costs.

Fiscal Impact

Increased revenues of up to $4.3 million annually to the Motor Vehicle Account (MVA) resulting from increased reimbursements to the CHP from governmental entities that utilize the department's helicopter services.

Analysis

The CHP operates five helicopters which are used for the following purposes: (1) CHP law enforcement and traffic management, (2) assistance provided to local, state and federal agencies, (3) emergency medical services, and (4) search and rescue missions. All helicopter program activities are supported by the MVA. For 1989-90, the patrol is requesting $7.4 million to support these helicopter activities.

Our analysis indicates that, of the $7.4 million requested, almost $4.3 million ($2.8 million for direct charges and $1.5 million for indirect operational costs), or 58 percent, is for assistance to various federal and local entities. Thus, on a cost basis, the CHP helicopter program primarily serves other governmental agencies.

We can find no justification to use funds from the MVA to support all of the costs of the helicopter program, without any reimbursements from the agencies which benefit from these services. Thus, we recommend the enactment of legislation requiring nonstate governmental entities to reimburse the department for helicopter services.

Reference

1987-88 *Analysis*, page 293. ❖

Department of Transportation
Abandoned Railroad Right-of-Way Acquisition Program

Recommendation

We recommend the enactment of legislation to (1) abolish the single purpose abandoned railroad right-of-way acquisition program and the Abandoned Railroad Account (ARA) established to support that program and (2) transfer any remaining balance in the ARA in the State Transportation Fund to the Transportation Planning and Development (TP and D) Account in the State Transportation Fund.

Fiscal Impact

One-time transfer of up to $450,000 from the ARA to the TP and D Account.

Analysis

The Abandoned Railroad Account (ARA) was created to provide a dedicated source of funds for acquiring abandoned railroad rights-of-way in cases where they could be used for public transportation purposes. These purposes include, but are not limited to, highways, busways, bicycleways, pedestrian paths, or transit guideways. In the past, funds from the account have been used to acquire right-of-way to widen streets and highways, extend transit guideways, and establish equestrian trails, bicycleways and pedestrian paths.

The ARA received its funding from two transfers totaling $6.5 million from the TP and D Account--an initial transfer of $3.5 million in Ch 1130/75 which established the ARA, and an additional transfer of $3 million in Ch 1098/77.

The ARA program differs from most acquisition programs because it focuses on the *type* of property acquired (that is, abandoned railroad right-of-way), rather than on the ultimate *use* of the property. Consequently, in nearly all cases the ARA provides a duplicative funding source for projects which also qualify under other programs which focus on the end use of the property. For example, right-of-way for highways generally is purchased with funds from the State Highway Account. Likewise, acquisitions for transit guideway projects are eligible for funding from the TP and D Account under the Transit Capital Improvement program and the State Highway Account under the Article XIX Guideway program.

The Legislature recognizes this duplication of effort and has made no new appropriations from the ARA for projects since 1983. Most recently, in the 1985 Budget Act, the Legislature adopted language to transfer all funds not needed for outstanding projects from the ARA to the TP and D Account. Despite these efforts, a balance of about $400,000 remains in the ARA.

We see no reason to continue a duplicative program and funding source which focuses on the narrow purpose of purchasing only abandoned railroad right-of-way, especially given the inactivity in the account in recent years. Accordingly, we recommend the enactment of legislation to (1) abolish both the abandoned railroad right-of-way acquisition program and the ARA in the State Transportation Fund and (2) transfer any remaining balance in the ARA to the TP and D Account. ❖

Mandated Local Costs
Disabled Motorist Assistance Program

Recommendation

We recommend the enactment of legislation to repeal the mandate which requires local traffic law enforcement agencies to establish Disabled Motorist Assistance Programs.

Fiscal Impact

Unknown, potentially multi-million dollar annual savings to the General Fund resulting from discontinuing payments to local governments for Disabled Motorist Assistance Program costs.

Analysis

State law requires every traffic law enforcement agency to establish a Disabled Motorist Assistance Program. Specifically, agencies are required to develop, adopt and implement a written policy to provide assistance to motorists stranded on city or county streets and roads. The Commission on State Mandates estimated the statewide cost of this mandated program to be $10.6 million from January 1, 1986 through June 30, 1989.

We have two concerns with the mandate for a Disabled Motorist Assistance Program. First, our analysis indicates that these programs do not serve a statewide interest, but primarily a local interest. Specifically, services provided by local traffic law enforcement agencies under their Disabled Motorist Assistance Programs benefit disabled motorists traveling on city and county streets and roads. Traditionally local jurisdictions have paid for all services on these streets and roads.

Second, the mandate may not be necessary to insure the provision of disabled motorist services. Specifically, we conducted a survey of cities and counties with Disabled Motorist Assistance Programs. We found that (1) prior to the enactment of this requirement many local law enforcement agencies provided these services on an informal basis and (2) the majority of cities and counties would continue their programs even if the state mandate were repealed. For these reasons, we recommend the enactment of legislation to repeal the mandate which requires local traffic law enforcement agencies to establish Disabled Motorist Assistance Programs.

Reference

State Reimbursement of Mandated Costs: A Review of Statutes Funded in 1988, page 31, January 1989. (Report Number 89-1.) ❖

California Coastal Commission
Coastal Development Permit Fees

Recommendation

We recommend the enactment of legislation to require the California Coastal Commission to increase fees to cover the full costs of its permitting program.

Fiscal Impact

Unknown annual General Fund revenue increase depending on (1) the increased fee amount charged for coastal permit applications and (2) the number and type of coastal permits processed.

Analysis

The Coastal Commission regulates development in the coastal zone and administers the state's coastal management program. Among other things, the commission (1) processes, monitors, and enforces coastal development permits, (2) provides technical and financial assistance to local jurisdictions involved in the coastal planning process, (3) evaluates and approves local coastal programs (LCPs), and (4) reviews LCP amendments.

In those areas of the state where an LCP has been certified, local agencies have the authority to grant permits for coastal zone development projects. The Coastal Commission retains this authority in areas without certified LCPs. Both the commission and local agencies charge fees to review applications for coastal development permits. Current commission permit fees result in annual General Fund revenue of approximately $150,000.

Our analysis indicates that the commission's permit fees should be increased because currently these fees do not cover the full cost of permit application review, or of permit monitoring and enforcement. Currently, the commission's permit fees range from $25 for a minor permit to $2,500 for a larger multi-unit development permit. When a local agency acts as the permitting authority under an approved LCP, it generally charges fees that either (1) cover the full cost for permit processing or (2) are several times higher than those charged by the commission. In fact, local permit fees often range from $125 for a minor project to $10,000 for larger developments. We cannot determine at this time the extent to which permit-related costs at the commission differ from local costs for similar activities. However, it appears that local agencies are recovering more of their permit-related costs from permit applicants than is the commission.

Accordingly, we recommend that legislation be enacted directing the California Coastal Commission to establish permit fees based on full cost recovery for the permit review program. The Legislature could use the increased fee revenue for any General Fund purpose, including enhancement of the commission's ability to review, monitor, and enforce permits. The fiscal impact of raising coastal permit fees will result in unknown annual revenue to the General Fund. The amount of the revenue increase depends on (1) the increased fee amount charged for coastal permit applications and (2) the number and type of coastal permits processed. ❖

Department of Food and Agriculture
Export Promotion Program

Recommendation

We recommend the enactment of legislation requiring the Director of the Department of Food and Agriculture and his advisory committee to include (1) self-sufficiency as an additional criterion for continuation of grant funding under the Foreign Market Development Export Incentive Program and (2) limit grant funding to five years for each participant.

Fiscal Impact

Potentially frees up unknown amount of funds to support additional new export marketing projects.

Analysis

The Foreign Market Development Export Incentive Program provides grants to participants for the purposes of creating, expanding or maintaining markets abroad for California agricultural products. Participants must be entities actively engaged in marketing agricultural commodities, and can include private companies, nonprofit agricultural marketing organizations, and state and federal marketing order boards or commissions. The grants are provided on a matching basis and total $5 million annually. The grants are awarded on the basis of proposals submitted each year to an advisory board that makes recommendations to the Director of the Department of Food and Agriculture.

Since its inception, the program has received 514 applications and funded 340 projects. Some of the participants are new each year, but some have received grants previously. In fact, 15 participants have received grants each year since 1985-86. Our analysis has identified two problems with the program. First, some participants who have been involved in the program may have developed export marketing techniques and programs that more than pay for themselves in increased sales abroad. These participants no longer need state support to help them establish marketing programs, and are likely to continue their programs even if state support is withdrawn. By eliminating state support for self-sufficient entities, the state could free up funds to support additional new export marketing projects.

Second, because the program does not require participants to become self-sufficient, it is possible that some will continue in the program indefinitely even though the total costs to the program--both participant costs and state costs--exceed the benefits to the individual participant. By eliminating state support for projects that cannot demonstrate cost-effectiveness after a reasonable period of time, program resources can be reallocated to projects with a greater probability of success.

Accordingly, we recommend that legislation be enacted (1) specifying export marketing self-sufficiency as one of the goals of the Export Promotion Program and (2) requiring that state support for participants be limited to no more than five years in the program. ❖

Department of Forestry and Fire Protection
Timber Harvest Permit Fees

Recommendation

We recommend the enactment of legislation requiring the Department of Forestry and Fire Protection to impose fees on timber operators to cover a portion of the cost of administering the Forest Practice Act.

Fiscal Impact

Increased revenue of up to $6.2 million annually to the General Fund and various special funds.

Analysis

The Forest Practice Act prohibits timber harvesting unless harvest operations comply with a timber harvesting plan (THP) prepared by a registered professional forester and approved by the Director of the California Department of Forestry and Fire Protection (CDFFP). The THP covers such things as harvest volume, cutting method, erosion control measures, and special provisions for unique areas or wildlife that will be affected by harvesting operations. The department conducts an initial review of the THP to ensure that it conforms with state requirements and rules adopted by the State Board of Forestry. The CDFFP also conducts field inspections at various stages of harvesting operations to ensure that timber operators actually comply with the THP. In 1987, the department reviewed about 1,300 THPs and conducted more than 8,000 field inspections.

The 1989-90 budget proposes expenditures of $6.2 million for the forest practice regulatory program, including $4.9 million from the General Fund, $1.1 million from the Cigarette and Tobacco Products Surtax Fund, and the remainder from various special funds and license fees.

Control language in the 1981 Budget Act directed CDFFP to establish a system of permit fees to cover a portion of the department's cost of administering the Forest Practice Act. The control language was based on the department's assurances to the Legislature that it had the authority under the California Environmental Quality Act (CEQA) to charge the timber industry a portion of the state's costs to regulate timber harvesting. After enactment of the 1981 Budget Act, however, the Attorney General concluded that the department did not have the authority to impose fees to finance the costs of the Forest Practice Act.

The cost of similar regulatory programs administered by other state agencies are either fully or partially reimbursed through industry fees and assessments. For example, the pesticide program administered by the Department of Food and Agriculture, and the waste discharge program administered by the State Water Resources Control Board are reimbursed through industry fees. The fees are charged on the theory that the beneficiaries of such services should pay for these regulatory costs. Therefore, we recommend the enactment of legislation requiring the CDFFP to establish a system of permit fees that covers at least a portion of the cost of administering the Forest Practice Act. ❖

Department of Water Resources
Safe Drinking Water Bond Program Improvements

Recommendation

We recommend that the Legislature incorporate the following changes to the Safe Drinking Water Program in any future Safe Drinking Water Bond Act:

- *Require the Department of Health Services (DHS) to alter the composition of its existing advisory commission and expand its functions to include review of safe drinking water project selection. The commission should (1) have expertise in both bacteriological and toxic chemical contamination health problems; (2) include experts from outside the DHS; (3) include public health specialists and sanitary engineers; and (4) present written recommendations on the components of a project ranking system to the Director of the DHS.*
- *Restrict safe drinking water loan funds to water agencies with a demonstrated financial need.*
- *Require the Department of Water Resources (DWR) to develop and publish a manual to guide staff in conducting the financial review of safe drinking water grant and loan applications.*
- *Place a ceiling on the amount of state funding provided per service connection for projects funded under the program.*

Fiscal Impact

Minor costs to the General Fund to change the composition of the DHS's advisory commission.

Analysis

The California Safe Drinking Water Bond Program provides grants and low-interest loans to assist local water agencies in meeting minimum state drinking water standards. Four bond acts, approved in 1976, 1984, 1986 and 1988, have provided a total of $425 million for the program.

The DHS ranks funding applications according to the seriousness and immediacy of the health threat addressed by each project, while the DWR determines the ability of water suppliers to repay a loan and the need for any requested grant.

Currently, the maximum loan amount is $5 million and the maximum grant amount is $400,000. The majority of water agencies receiving funding under the program are very small, publicly owned systems with fewer than 200 connections, primarily located in the rural areas of the state.

We have identified four problems with the current Safe Drinking Water Program. Specifically, these are:

1. The project ranking system currently used by the DHS is not sensitive to health risks posed by different types of toxic chemical contamination and does not weigh those risks against more traditional types of water system deficiencies, such as bacteriological contamination.

2. Neither the DHS nor the DWR consider financial need as a criterion for approving loans. As a consequence, less money may be available to water agencies that do not have any other source of funding for system improvements.

3. Under the existing program, the DWR has no specific criteria to determine whether an applicant can repay a loan or needs a grant. This means that the DWR could make inconsistent financial determinations.

4. Some projects have very high costs per service connection, raising the question of whether funding them is an efficient and equitable use of bond funds.

Because of these problems, we recommend that any future Safe Drinking Water Bond Acts (1) revise the composition and functions of the DHS's advisory commission in order to help the DHS balance the threats of bacteriological contamination with contamination from toxic chemicals, (2) restrict loan funds to districts that can demonstrate financial need, (3) require the DWR to develop a staff manual for financial review of grant and loan applications, and (4) establish a per-connection funding ceiling.

Elsewhere in this report we recommend enactment of legislation that requires the DHS to promote consolidation of water systems in the Safe Drinking Water Bond Program. (Please see the issue "Regulation of Small Water Systems" under the Department of Health Services.)

Reference

The Safe Drinking Water Bond Program: A Review, January 1988. (Report Number 88-2.) ❖

State Assistance Fund for Energy, California Business and Industrial Development Corporation (SAFE-BIDCO)

Elimination of Program

Recommendation

We recommend the enactment of legislation to eliminate the SAFE-BIDCO program because the program has not been successful in achieving its statutory objectives.

Fiscal Impact

One-time increase in General Fund revenues of approximately $3.3 million from the liquidation of SAFE-BIDCO's assets.

Analysis

The State Assistance Fund for Energy, California Business and Industrial Development Corporation (SAFE-BIDCO) was established by Ch 819/80 to make loans to small businesses involved in alternative energy production or energy conservation. In subsequent legislation, (Ch 1338/86) SAFE-BIDCO's role was expanded to make nonenergy loans to minority-owned small businesses and small business export financing loans. SAFE-BIDCO is not a state agency, but rather a nonprofit corporation.

Chapter 1338 also established within SAFE-BIDCO a program to provide low-interest loans to small businesses to finance the installation of energy conservation measures, electrical load management equipment or other devices to improve energy efficiency. The act continuously appropriates $3 million from federal funds in the Petroleum Violation Escrow Account (PVEA) to implement the program. This component of the SAFE-BIDCO program is scheduled to sunset on December 31, 1995.

In a recent report, we recommended the enactment of legislation to eliminate SAFE-BIDCO. Our evaluation of SAFE-BIDCO's performance over the past seven years indicates that it has failed to achieve its statutory objectives regarding financial self-sufficiency and loan volume. Specifically, SAFE-BIDCO's expenses have exceeded its income in six of the seven years of its operation. In addition, SAFE-BIDCO's loan activity over the past seven years has fallen short of the goals set by its Board of Directors. In fact, SAFE-BIDCO has experienced a sharp decline in loan activity in recent years.

Analysis CONTINUED

SAFE-BIDCO's recent lending history indicates that the demand for its alternative energy loans is not sufficient to warrant the continuation of the program. Although SAFE-BIDCO has begun to redirect its focus toward the financing needs of minority-owned small businesses and small business exporters, our analysis indicates that these efforts are duplicative of existing state programs and its lending approach is not a cost-effective means of providing financing to these groups. The Legislature, if it chooses, could serve these groups more effectively by appropriating some portion of SAFE-BIDCO's resources to other similar programs in the Department of Commerce and the World Trade Commission.

Therefore, we recommend the enactment of legislation to eliminate SAFE-BIDCO and revert its funding to the General Fund. We further recommend that the PVEA low-interest conservation loan program be transferred either to the California Energy Commission or the Department of Commerce, each of which is operating a similar program.

Reference

An Evaluation of the State's Alternative Energy Finance Program (SAFE-BIDCO), January 1989. (Report Number 89-3.) ❖

Analysis CONTINUED

quired to recover their costs from the owners of leaking underground tanks.

Although local agencies participating in the pilot program are required to recover their costs for overseeing the cleanup of leaking underground tanks, no similar requirement for cost recovery exists for the state regional boards which oversee the cleanup of leaking underground tanks not covered under the program. Consequently, tank owners are required to pay for oversight costs if these costs are incurred by a local agency, but do not have to pay for the same costs if incurred by the state. For the purposes of cost recoveries, we see no reason to distinguish between oversight performed by local agencies under contract to the state and direct state oversight. Accordingly, we recommend enactment of legislation requiring the State Water Resources Control Board to implement a program to recover from underground tank owners the state and regional boards' costs for overseeing the cleanup of leaking underground tanks.

Reference

1987-88 *Analysis*, page 491. ❖

State Water Resources Control Board
Leaking Underground Tanks Oversight Fees

Recommendation

We recommend the enactment of legislation requiring the State Water Resources Control Board to establish a program to recover from the owners of leaking underground tanks all state and regional board costs for overseeing the cleanup of the sites.

Fiscal Impact

Increased annual General Fund revenue of up to $3.1 million.

Analysis

The State Water Resources Control Board's (SWRCB) budget request for 1989-90 includes approximately $3.1 million from the General Fund for regional board personnel to directly oversee the cleanup of leaking underground tanks. Underground tanks are used to store petroleum and industrial chemicals and, if they leak, can pose a serious threat to groundwater. The board estimates that a total of 12,000 to 31,000 underground tanks are leaking statewide, and potentially contaminating soil and groundwater. In order to ensure that the tanks, as well as any contaminated soil or groundwater, are cleaned up properly, state and local agencies oversee the cleanup of the tanks.

In our *Analysis of the 1987-88 Budget Bill*, we recommended enactment of legislation that would allow the SWRCB to recover from the owners of leaking underground tanks the state and regional boards' costs for overseeing the tank cleanup. Recovery of such costs would (1) increase revenue to the General Fund by up to $3.1 million, (2) enable the Legislature, if it wishes, to increase regional board personnel for overseeing the cleanup of leaking tanks, without a net General Fund increase, and (3) be consistent with the state's funding policy for cleanup oversight at other toxic contamination sites.

Since the time that we made our recommendation, the Legislature has taken actions related to the cleanup of leaking underground tanks that further support this recommendation. In 1987-88, the Legislature authorized the SWRCB to implement a program for contracting with local agencies to oversee the cleanup of leaking underground tanks. Under the pilot program, participating local agencies are re-

Commission on State Finance
Update of the California Necessities Index (CNI)

Recommendation

We recommend the enactment of legislation to modify the method used to calculate the CNI in order to reflect more recent information.

Fiscal Impact

Unknown, potentially major (millions of dollars) annual costs or savings for cost-of-living adjustments for specified welfare programs.

Analysis

State law created the CNI to measure the rate of inflation for a specific market basket of goods and services, each of which is weighted according to the consumption patterns of low-income consumers. In addition, state law requires that the CNI be used to adjust annually the grants provided through the Aid to Families with Dependent Children-Family Group and Unemployed parents (AFDC-FG & U) programs and the Supplemental Security Income/State Supplementary Program (SSI/SSP). The Commission on State Finance is the state agency responsible for estimating the change in the CNI.

The CNI is based on a subset of the items included in the California Consumer Price Index (CCPI) market basket. The CCPI is based on a comprehensive market basket of all goods and services which consumers purchase. The CNI subset includes the categories of food, apparel and upkeep, fuel and other utilities, residential rent, and transportation, which more closely reflect the buying patterns of low-income consumers. The weights assigned to each CNI expenditure category were originally developed in 1979 using household spending data from a 1972-73 survey.

Beginning in 1987, the U.S. Bureau of Labor Statistics (BLS) updated the expenditure weights assigned to the market basket of goods and services used in the CCPI to reflect household spending habits surveyed in the 1980s. Under current state law, however, the CNI does not incorporate these changes, but continues to be based on consumption patterns of low-income households during the 1970s.

The *Supplemental Report of the 1988 Budget Act* required the Commission on State Finance to report to the Legislature on available methodologies for updating the CNI. The commission submitted its report in November 1988, and recommended a methodology that uses BLS household survey data from the 1980s. The methodology would be the same as that currently used to compute the CNI, except that it would include more up-to-date information on the consumption habits of low-income households.

The report also shows the effect that the updated expenditure weights would have had on the CNI (and, consequently, on cost-of-living adjustments for the AFDC-FG & U and SSI/SSP programs) in recent years. In 1987 (the most recent year for which the actual CNI has been computed), the current and recommended weights would have produced the *same* inflation adjustment for these programs--a 4.7 percent increase. During the period from 1980 through 1987, however, the weights recommended by the commission would have produced significantly *lower* inflation adjustments than the current weights. During that period, the average annual rate using the current calculation method was 5.4 percent, while the recommended method would have yielded adjustments of 4.9 percent.

We believe that bringing the CNI up to date by modifying the way it is calculated, is appropriate because it would more accurately reflect changes in the cost of living currently experienced by low-income households. Therefore, we recommend that the Legislature enact legislation to modify the method of calculating the CNI as recommended by the Commission on State Finance. ❖

Department of Health Services
Clinical Laboratory Inspection and Enforcement

Recommendation

We recommend the enactment of legislation that requires the Department of Health Services (DHS) to (1) conduct biennial inspections of clinical laboratories, (2) adopt regulations that specify minimum laboratory performance standards, and (3) increase the licensing fees for clinical laboratories by an amount sufficient to cover the General Fund costs of the regulatory program.

Fiscal Impact

Increased General Fund costs of approximately $250,000 annually to the General Fund offset by approximately $1 million annually in increased license fee revenues.

Analysis

The clinical laboratory licensing program in the DHS establishes and enforces minimum standards for clinical laboratories. The program regulates approximately 2,030 clinical laboratories: 930 Medicare-certified laboratories that are subject to both state and federal regulations and 1,100 laboratories subject to state regulation only (state-only laboratories).

We have identified two problems with the clinical laboratory licensing program. First, the DHS reports that the quality of laboratory tests performed in state-only laboratories is poor. Second, the clinical laboratory license fees only cover 35 percent of the General Fund costs of the regulatory program.

Poor Quality. According to the DHS, the state-only laboratories have a greater number of violations, more serious violations, and more repeat violations than Medicare-certified laboratories. The DHS indicates that these differences are due to differences in enforcement programs.

There are two key areas where the Medicare and the state-only enforcement programs differ. First, federal regulations require 60 percent of the Medicare laboratories to be inspected annually; while, currently, the DHS inspects state-only laboratories once every three to eight years. Second, federal regulations require Medicare laboratories to meet certain performance standards to ensure quality control in processing laboratory samples. State regulations require laboratories to have an "adequate" quality control program, but do not establish criteria for determining whether a program is adequate. According to DHS, it uses the Medicare laboratory performance standards when inspecting state-only laboratories, but it cannot require compliance with the guidelines because they are not regulations.

The problems with the state-only laboratories will be ameliorated in the long term as a result of new federal requirements enacted in the Clinical Laboratory Improvement Amendments of 1988 (CLIA). The CLIA requires the federal Department of Health and Human Services (DHHS) to establish a certification program for non-Medicare laboratories nationwide. A state can administer its own program in place of the new CLIA certification program if the state program is as stringent as the federal program. The CLIA requires the DHHS to adopt performance standards through regulation by January 1, 1990 and conduct inspections beginning July 1, 1991. The DHS expects the standards developed for the non-Medicare laboratories under the CLIA will be consistent with the existing standards for the Medicare laboratories. The CLIA also requires a fee structure to be established to fully support the costs of administering the program.

Program Funding. Currently, the license fees for laboratories are $273 for initial licenses and $215 for renewals. These fees are imposed on private laboratories only and cover 35 percent of the General Fund costs of regulating these laboratories.

The department could provide no justification for the license fees continuing to be below the cost of operating the program. Other licensing programs in the department fully support the costs of licensing private facilities through fees.

Recommendation. Our analysis indicates that there would be substantial benefits to enhancing enforcement at state-only laboratories, in line with Medicare-certified laboratories, during the two-year interim period before the CLIA is fully implemented (July 1, 1991). To achieve these benefits would require more enforcement staff to increase inspection frequency, and additional authority to enforce performance standards. Based on its experience with Medicare-certified laboratories, the DHS believes that performing inspections every two years would ensure adequate compliance with performance standards.

Our review also indicates that clinical laboratory licensing fees should be increased to pay the General Fund costs for regulating private laboratories. This would be consistent with many other licensing programs.

Therefore, we recommend enactment of legislation that requires the DHS to (1) conduct inspections every two years at state-only laboratories, (2) expand the existing regulations to include performance standards similar to the Medicare standards currently in state guidelines, and (3) increase the license fees by an amount sufficient to cover costs of regulating private laboratories. The department estimates the costs of additional enforcement staff to perform inspections every two years would be approximately $250,000 annually. The fees needed to pay for both the existing General Fund program costs and new staff to regulate private laboratories would average $730 for each laboratory. According to the department, this would not impose an unreasonable burden on private laboratories subject to the fee. ❖

Department of Health Services
Regulation of Small Water Systems

Recommendation

We recommend enactment of legislation:

- *Encouraging consolidation of small water systems.*
- *Establishing financial responsibility requirements for new water systems.*
- *Expanding the state's authority to enforce regulations and requiring the state to establish minimum requirements for county regulatory programs.*
- *Revising the existing funding structure for state and county regulatory programs.*
- *Requiring the Department of Health Services (DHS) to adopt more stringent requirements for certification of water treatment operators.*

Fiscal Impact

Annual General Fund savings of approximately $3.5 million.

Analysis

State law (the Safe Drinking Water [SDW] Act) requires the DHS to regulate large water systems (200 connections or more) and delegates authority for regulating small water systems (fewer than 200 connections) to the counties. According to the DHS, there are approximately 1,400 large water systems, which serve approximately 26 million people, and approximately 12,450 small water systems, which serve approximately 700,000 people.

The SDW Act imposes numerous requirements on drinking water systems. In general, each water system must (1) meet water quality standards, (2) monitor water quality, (3) notify water users when it does not meet water quality standards, and (4) meet water system design and operation standards.

Despite a large infusion of funds ($350 million) over a 10-year period, the DHS estimates that 40 percent of small water systems have major violations with drinking water requirements. In our review of the small water system program, we identified problems at the state, county, water system, and water treatment operator level. To address these problems, we recommend enactment of legislation as discussed below. Although these recommendations are presented separately, they are strongly related and, therefore, we view the recommended legislation as a package.

1. Increase Water System Ability to Pay for Drinking Water Requirements

Our review indicates that compliance with drinking water requirements has been more difficult for small water systems than for large ones because (a) small systems do not have as many connections over which to spread costs and (b) small systems are usually unable to obtain loans. We identified two ways of ensuring that water systems are able to finance improvements.

Consolidation of Existing Systems. Consolidating small water systems that are in relatively close geographic proximity to one another can be an effective way to increase a water system's ability to pay for water system costs--and increase the likelihood that improvements are made.

Due to the significant benefits of consolidation, we recommend enactment of legislation that:

- Requires counties, as part of their local regulatory programs, to develop consolidation plans for areas where consolidation appears geographically feasible. (The funding for this activity is discussed in our next recommendation.)
- Requires the DHS to evaluate and revise any SDW bond policies or regulations that may indirectly discourage rather than promote consolidation.
- Requires consolidation plans to be submitted at the time the final applications for loans and grants are submitted.
- Requires projects funded by the bond program to be consistent with the consolidation plan. (We have a related recommendation for legislation concerning the SDW bond program under the Department of Water Resources in this report.)

Financial Responsibility Requirements. The DHS and the counties, when issuing permits to new water systems, do not evaluate the system's ability to finance future water system improvements and maintenance. The Public Utilities Commission (PUC), which regulates water rates for private water companies, has adopted a policy to require companies to demonstrate financial responsibility at the time they request a PUC certificate.

To ensure that new publicly operated, as well as private, water systems have the financial ability to provide safe drinking water, we recommend the enactment of legislation that requires (a) new water systems not regulated by the PUC to demonstrate financial responsibility as a condition for receiving a state or county permit and (b) the DHS to adopt regulations that specify the financial responsibility criteria to be used in the permit process.

2. Increase Oversight and Enforcement

Our analysis indicates that additional DHS oversight of county programs and enforcement of small water system regulations would improve small water systems' compliance with drinking water requirements. Strengthening state and county regulatory programs will result in additional costs. We address funding for these costs in the next section.

Funding for Regulatory Programs. We identified two major problems with the funding system for the existing drinking water regulatory programs. First, county funding currently appears to be insufficient to implement a small water system regulatory program that meets the requirements of federal and state law. For counties to adequately regulate a small water system program, the DHS has a preliminary estimate that counties need an additional 106 positions at a cost of approximately $4.2 million annually. Funding the existing 44 county positions as well as an additional 106 positions would cost $6 million. The final determination of the funding needed to implement the county programs will depend on the minimum program requirements established by the DHS.

Second, the current funding system for the large and small water system regulatory programs does not equitably distribute the funding burden between these systems. Specifically, the large water systems that can more easily pay a fee because they have many connections over which to spread costs do *not* pay any fees, while the small systems which are more likely to need financial assistance in most cases pay a fee.

Recommendation. To improve oversight and enforcement and to provide funding for increased regulatory activities, we recommend the enactment of legislation that:

- Requires the DHS to adopt regulations establishing requirements for county programs. At a minimum, the requirements should provide for (a) timely and accurate small water system compliance data to the state, (b) conducting inspections according to a specified frequency, and (c) enforcement actions against violations within a specified timeframe.

- Requires the DHS to (a) oversee the adequacy of the county programs and take enforcement actions if a county fails to meet minimum requirements and (b) develop and implement a policy specifying how it will oversee county programs and under what conditions it will intervene in county programs.
- Requires the DHS to impose a fee on all large water systems to cover the cost of regulating those systems.
- Requires counties to impose fees on small water systems to cover the cost of their regulatory programs.

The cost of the large water system regulatory program, currently supported by the General Fund, is approximately $4 million annually. Collecting this level of fees would free up $4 million in General Fund resources. The DHS will need a portion of the $4 million General Fund savings, probably less than $500,000 annually, to oversee county programs. Based on our review, it does not appear that the large or small water system fees would impose an unreasonable burden.

3. Increase Knowledge of Water Treatment Operators

We identified three problems with the current program for certifying operators. First, even though chemical contamination has recently been recognized as a problem in drinking water systems, the DHS indicates the minimum qualifications and examinations have not been revised to reflect these changes.

Second, the DHS does not require operators to be retested or meet continuing education requirements to renew their certificates even though water treatment technology has become more sophisticated since 1971, when operators were first certified.

Third, although the size of a system does not necessarily reflect the complexity of the treatment process, the education and knowledge requirement of each certificate grade increases as the size of the water system being operated increases. As a result, those smaller-quantity water systems which have complex treatment facilities may not have operators with adequate expertise to ensure a safe drinking water supply.

To reduce the likelihood of water system problems due to unqualified operators, we recommend the enactment of legislation that requires the DHS to adopt regulations that (a) revise the minimum qualifications and examinations for certification of water

Analysis CONTINUED

treatment operators to include education, knowledge, and experience in chemical contamination and treatment processes, (b) requires operators to reapply and be retested periodically to renew their certificate, and (c) require increasing qualifications for operation of more complex treatment facilities and processes. The DHS should establish the appropriate renewal period in regulations.

Reference

1989-90 *Analysis*, Item 4260. ❖

Department of Social Services
Independent Adoption Fees

Recommendation

We recommend the enactment of legislation to permit the Department of Social Services (DSS) and county adoption agencies to charge a sliding scale fee to cover all, or a portion of, their costs to interview parents and file court reports in the Independent Adoptions program.

Fiscal Impact

Unknown increase in General Fund revenues depending on (1) the amount of the fee that would be charged parents with various incomes, and (2) the number of cases in which the fee is waived.

Analysis

The DSS administers a statewide program of services to parents who wish to place children for adoption and to persons who wish to adopt these children. Adoptions services are provided through state and county adoption agencies, and a variety of private adoption agencies. The Adoptions program has two components: relinquishment adoptions and independent adoptions.

Under the Relinquishment Adoptions program, a child is placed by an adoption agency with adoptive parents when the relationship between the natural parents and the child is terminated, either voluntarily or by a court order.

Current law permits the state and county adoption agencies to charge a fee of up to $500 to prospective adoptive parents in the Relinquishment Adoptions program. In most cases, however, the fees are waived because the child is "hard to place." (Children are considered hard to place for a variety of reasons, including older children, children with chronic diseases, and children who are in sibling groups.)

Under the Independent Adoptions program, the natural parents, instead of an adoption agency, place the child directly with the adopting parents of their choice. These adoptions are usually arranged by a private attorney or adoption agency for a substantial fee. (According to the DSS, these parents pay fees of $10,000 or more per adoption to cover attorney, medical, and administrative costs.) The role of the state and local adoption agencies in an independent adoption is limited to visiting the home of the adoptive parents and preparing a report--referred to as a home study. The court uses the home study, in combination with other information to determine whether the adoption is in the best interest of the child, the natural parents, and the adoptive parents.

Very few children adopted through the Independent Adoptions program are "hard to place." In fact, most of these adoptions involve healthy newborns or infants, which are generally regarded as the easiest to place children since they are in the greatest demand. Under current law, however, the state and county adoption agencies are *not* permitted to charge a fee to cover their costs of preparing home studies for independent adoptions.

Our analysis indicates that it would be appropriate to allow adoption agencies to charge a fee to cover their costs to conduct home studies in independent adoptions for the following reasons:

- *The benefits from an adoption accrue* ***primarily*** *to the adoptive parents, the child, and the natural parents.* Obviously, society as a whole *does* have an interest in ensuring that these adoptions are appropriate and successful. In fact, the role of the court in these cases is primarily to safeguard this interest. Most of the direct benefits of these adoptions, however, are experienced by the parties directly involved, particularly the adoptive parents.
- *The Legislature could use the fee revenues to make the Independent Adoptions program more responsive to the needs of the prospective adoptive parents.* Under current law, the Independent Adoptions program must compete with the Relinquishment program for staff and with other programs for support from the General Fund. In the past, General Fund support has not kept pace with caseload increases. As a result, the department advises that state adoption offices have a backlog of 538 cases in the program. The Legislature could use all, or a portion of, the fee revenues to increase program staff in order to meet increasing workload demands.
- *A fee for independent adoptions services would not create a barrier for most prospective adoptive parents in the program.* Most prospective adoptive parents in the Independent Adoptions program have sufficient incomes to permit them to pay a fee for service. In 1986-87, 62 percent of adoptive parents had gross annual household incomes over $40,000 and 47 percent had gross annual household incomes over $50,000. We recognize, however, that it is important to ensure that the fee

not impose an undue financial burden on adoptive parents. Therefore, the legislation should require the department to develop a sliding scale fee schedule that would assess a fee for services based on the prospective adoptive parents' ability to pay. In addition, legislation should provide for a waiver of the fee in some cases, especially cases involving hard-to-place children.

The fee would result in an unknown increase in General Fund revenues depending on (1) the amount of the fee that would be charged parents with various incomes, and (2) the number of cases in which the fee is waived. The fee revenues could be used to offset existing General Fund costs, to expand state and county adoption agency staffing, or a combination of both. The Legislature will need to resolve these issues before implementing an independent adoption fee. ❖

Department of Education
Continuation High School Funding

Recommendation

We recommend the enactment of legislation which establishes a separate revenue limit for continuation high schools.

Fiscal Impact

Additional General Fund costs of approximately $320,000 in 1989-90, and increasing amounts annually thereafter, due to establishing a separate revenue limit for continuation high schools. Costs result from existing statutory cost-of-living adjustments being applied to newly created continuation high school revenue limits. The fiscal impact of workload adjustments to these revenue limits is unknown.

Analysis

Current law requires unified and high school districts to maintain one or more continuation high schools (or classes) for students, age 16 and over, as an alternative to the regular instructional program. Funding for continuation schools is provided through two separate mechanisms: the revenue limit and a small-school funding formula. Only districts with schools established after 1978-79 may receive the small-school funds.

Our analysis indicates that the use of two separate funding mechanisms has resulted in (1) some districts (those with schools established after 1978-79) receiving significantly more funds per pupil than other districts and (2) inconsistencies in the manner in which funds are adjusted for inflation and workload changes.

Since there are no inherent differences between the funding needs of different schools, we believe it would be better to use one uniform funding formula for all schools. Specifically, we recommend that the Legislature create a special revenue limit for continuation high schools, based on the amount of funding per student.

Reference

1987-88 Analysis, page 931.

Department of Education, and California Community Colleges
Implementation of Proposition 98

Recommendation

We recommend the enactment of legislation to implement Proposition 98--The Classroom Instructional Improvement and Accountability Act.

Fiscal Impact

Unknown potential General Fund costs or savings in 1990-91 and annually thereafter, depending on the definition of enrollment.

Analysis

Proposition 98, the Classroom Instructional Improvement and Accountability Act, was approved by the electorate in November 1988. This measure establishes a constitutional requirement to provide a specified minimum level of funding for public elementary and secondary schools and community colleges.

Because the proposition is not self-implementing, legislation is needed in order to (1) define and implement specific provisions and (2) appropriate the required funds. We have identified the following four issues that we believe should be addressed in legislation in order to implement Proposition 98.

Expenditure of Current-Year Funds. The Legislature will need to decide how to spend the additional funds required by Proposition 98 in 1988-89. There are two broad ways in which these funds could be allocated: (1) as general purpose revenue, which districts could spend as they see fit or (2) as categorical program support, which the Legislature could target to specific programs. We recommend that, after setting aside an amount sufficient to fund potential K-12 education deficiencies, the Legislature target most or all of the Proposition 98 funds for specific programs or purposes. In this way, the Legislature will be able to ensure that funding is used according to its highest priorities.

Defining Enrollment. The initiative requires that school district and community college enrollment data be used to compute minimum funding requirements and to allocate excess revenues. Enrollment is defined by the initiative as:

- Average daily attendance (ADA) in K-12 schools.
- ADA equivalents for K-12 services not counted in average daily attendance.

- Full-time equivalent (FTE) students in community colleges.

We recommend that the implementing legislation include formulas for computing ADA equivalents for services not currently counted in ADA, such as summer school programs and enrollment in the state special schools and for converting community college ADA to FTE students.

Excess Revenue Cap. The initiative requires that K-12 schools and community colleges be allocated revenues in excess of the state appropriations limit, "up to a maximum of four percent (4%) of the total amount required pursuant to Section 8(b)." On the basis of discussions with Legislative Counsel, we assume that this is a reference to 4 percent of the total state General Fund support for this purpose. Others, however, have suggested that local property tax revenues should be included in the base for computing the 4 percent cap (thereby increasing the amount of funds allocated to schools and community colleges). Such an interpretation would increase the potential cost to the state. Based on our reading of Section 8(b) and discussions with Legislative Counsel, we recommend that the implementing legislation specify that the base *not* include local property tax revenues.

Identification and Allocation of Excess Revenue. The initiative requires the automatic allocation of excess revenues by the State Controller. It does not, however, indicate *when* the allocation should take place. To implement this provision, the Legislature must determine when it can be known how much (if any) excess revenue is available. We recommend establishing a procedure and timetable that would govern (1) the certification of the availability of excess revenues by the Director of Finance to the Controller and (2) the allocation of excess revenues by the Controller.❖

Department of Education
School Facilities Guaranteed Yield Funding Formula

Recommendation

We recommend the enactment of legislation establishing an alternative system for financing the construction of local school facilities. Specifically, we recommend that the legislation guarantee every school district a certain minimum revenue yield from a given tax rate so that all districts, regardless of their property tax bases, are able to raise sufficient revenues for financing their local school facilities needs.

Fiscal Impact

Unknown, but potentially major (hundreds of millions of dollars) reduction in demand for state school facilities construction aid, to the extent that the guaranteed yield schedule adopted by the Legislature results in an increase in local revenue raising activity.

Analysis

Our review indicates that the State School Building Lease-Purchase program, which provides hundreds of millions of dollars annually to school districts to finance their local school facilities needs, (1) fails to provide sufficient funds to meet districts' needs in a timely manner and (2) fails to distribute equitably the burden of paying for new school facilities. For these reasons, we recommend the enactment of an alternative funding mechanism--the Guaranteed Yield Funding Formula--that would address these problems.

Specifically, we recommend the enactment of legislation to guarantee every school district a certain minimum revenue yield from a given tax rate. The funding source for this guarantee would be the revenues from (1) school construction bonds issued by the state, (2) any statutorily authorized tidelands oil revenues, and/or (3) any other state-appropriated funds. The most likely funding source are school construction bonds. In broad outline, this new funding mechanism would work as follows:

- A district would submit information on its need for new school facilities to the State Allocation Board (SAB), which, in turn, would certify the accuracy of the district's estimates.
- The district would then consult a schedule showing the amount of revenue per pupil-to-be-

accommodated which it could raise from a given tax rate. This basic schedule would be the same for all districts throughout the state, even though the actual amount of local revenue raised by each tax rate would vary considerably among districts due to differences in assessed valuation. Such a schedule could include adjustment factors to reflect local differences in the costs of site acquisition and construction.

- Based on the costs of the facility per pupil-to-be-accommodated, the district would choose a tax rate from the guarantee schedule and submit this rate to its voters for their approval.
- If the voters approved the measure by a 2/3 vote, the district then would be authorized to levy the new tax rate. If the revenues raised by the tax were less than the amount guaranteed by the state schedule, the state would make up the difference. Those districts unable to receive the necessary voter approval to raise sufficient revenues locally could retain the option of participating in the existing Lease-Purchase program.

This approach to financing the construction of local school facilities offers the following advantages over the current system:

- It would enhance local control by enabling local school districts to develop their projects based on local, rather than state, priorities.
- It would provide local school districts with an opportunity to raise substantial amounts of money for new construction within a shorter period of time, because the role of the state in reviewing and approving applications would be substantially reduced.
- It would increase incentives for each school district to choose the most cost-effective solutions for its school facilities needs, because the beneficiaries of school construction projects would be required to pay at least some part of project costs.
- It would make local school districts more accountable to those they serve, because voter approval would be necessary before bonds could be sold.

References

The 1986-87 Budget: Perspectives and Issues, page 189.

1988-89 Analysis, page 884.❖

Department of Education
School Facilities Funding Allocation Formula

Recommendation

We recommend the enactment of legislation requiring State School Building Lease-Purchase program funds for new construction to be allocated to school districts as if the facility would be operated year-round.

Fiscal Impact

No direct effect on the State School Building Lease-Purchase Fund. However, the practical effect would be to increase by probably hundreds of millions of dollars the amount of new school facilities construction that could be financed from the Lease-Purchase Fund.

Analysis

As of November 1988, the state had an estimated $800 million in bond funds available to finance $4.3 billion in requests from school districts under the State School Building Lease-Purchase program. To the extent that school districts file additional requests for aid between now and the next time additional funds are made available, this disparity between requests and availability of funds will continue to grow.

Under current law, school districts qualifying for the state new construction aid program are awarded funds based on a complex formula. This formula assumes that the new school to be constructed will operate on a traditional nine-month calendar, rather than on a multitrack year-round calendar. However, our analysis indicates that the Legislature can increase the number of pupils that can be accommodated with available state revenues through the promotion of year-round schools. For example, a school that had been designed to accommodate 500 students on a nine-month calendar could accommodate at least 600 pupils on a year-round calendar (based on a minimum 20 percent capacity increase).

To the extent that the state were to allocate funds based on an assumed 20 percent capacity increase, we estimate that the $800 million currently available for expenditure could finance the equivalent of an additional $135 million in new facilities construction. If the state were to allocate funds on the assumption that newly-constructed schools could accommodate greater than a 20 percent capacity increase, additional expenditure could finance the equivalent of an additional $135 million in new facilities construction. If the state were to allocate funds on the assumption that newly constructed schools could accommodate greater than a 20 percent capacity increase, additional facility construction would be even greater.

Our analysis indicates that multitrack year-round programs greatly reduce the demand for school facilities, are educationally sound and provide a viable alternative to the traditional nine-month calendar educational program. In light of this, and given the state's limited financial resources for constructing new school facilities, our review indicates that it is appropriate for the state to promote the use of year-round education programs so as to maximize their use in lieu of the traditional nine-month calendar programs. Further, we can find very little analytical justification for the state to continue to provide funds under the Lease-Purchase program for the construction of traditional, rather than year-round, schools.

Accordingly, to maximize the number of pupils that can be housed with available state revenues, we recommend the enactment of legislation requiring that Lease-Purchase program funds for new construction be allocated to school districts as if the facility would be operated on ayear-round basis. In implementing this recommendation, the Legislature would not have to *require* districts participating in the Lease-Purchase program to operate year-round schools. Rather, the funds could be allocated *as if* the school were to be operated on a year-round basis. As a result, the district could retain the option to operate the school on a nine-month calendar basis, if locally raised funds were used to construct the larger (and more costly) facility needed to house the same number of students.

References

1988-89 Analysis, page 882.

The 1989-90 Budget: Perspectives and Issues.❖

Mandated Local Costs
Certification of Teacher Evaluators

Recommendation

We recommend the enactment of legislation to (1) eliminate an existing requirement that districts adopt rules and regulations to assist and evaluate new teachers and (2) specify the activities districts should undertake to ensure that teacher evaluators are competent.

Fiscal Impact

General Fund cost avoidance of at least $2 million annually, due to reduction of local mandated costs. (No additional budget savings compared to the 1989-90 Governor's Budget proposal.)

Analysis

State law requires school districts to adopt rules and regulations to (1) ensure that persons assigned to evaluate teachers are competent; (2) provide assistance to and evaluate probationary certificated employees; and (3) provide a process by which parents or guardians can present complaints about school personnel.

In enacting this requirement, the Legislature presumably intended that districts examine their current policies with the aim of improving the consistency of services in the area of teacher evaluation and support. In defining the scope of this mandate, however, the Commission on State Mandates (COSM) ruled that districts can claim open-ended annual costs for *self-designed* programs to train and certify teacher evaluators and assist beginning teachers. Thus, the scope of this mandate appears considerably broader than what was contemplated by the Legislature at the time of its enactment.

The COSM has estimated that this mandate will result in state costs of at least $582,000 annually. Our analysis, however, indicates that the actual costs of the program will be considerably higher than this amount. Based on our review of a similar program (discussed below), we estimate that the statewide costs of implementing programs to assist teachers could exceed $2 million annually. The costs of training teacher evaluators could be substantially higher.

The state currently is determining the most cost-effective way to train, assist, and evaluate new teachers. Specifically, Ch 1355/88, directs the Commission on Teacher Credentialing and the State Department

Analysis CONTINUED

of Education (SDE) to evaluate alternative methods of supporting and assessing new teachers. The two agencies are currently operating a $3.2 million pilot program to determine the most cost-effective ways to accomplish these objectives. At the end of this pilot program, which is expected to last from two to three years, these agencies will report to the Legislature on the results of their evaluation.

Our review of the portion of the mandate dealing with the parental complaint process indicates that it appears to be consistent with the statute and that the costs are reasonable. Accordingly, we recommend that the Legislature continue the existing requirements relating to this process.

With respect to the other components of the mandate, we are concerned that the mandate currently allows districts to receive unlimited funding for a multitude of activities. In order to remedy this problem, we recommend that the Legislature eliminate the provision requiring districts to adopt rules and regulations to train, assist, and evaluate new teachers, pending the outcome of the teacher training pilot program. This will ensure that the mandated rules and regulations ultimately incorporate the most cost-effective ways of supporting and training new teachers. In addition, we recommend the enactment of legislation to revise the provision relating to certification of teacher evaluators by specifying the activities districts should undertake in this area. This will protect the state from potentially major, open-ended costs for these activities.

Reference

State Reimbursement of Mandated Costs: A Review of Statutes Funded in 1988, page 17, January 1989. (Report Number 89-1.)❖

California Community Colleges
Health Services Fee

Recommendation

We recommend enactment of legislation deleting the current statutory limit on the amount that community college districts may charge to support student health services.

Fiscal Impact

Approximately $1.4 million savings to the General Fund in the first year, increasing annually thereafter.

Analysis

Under current law, 59 of the 70 community college districts are required to operate student health centers and provide health supervision and services. These districts are authorized to charge students a health services fee of no more than $15 per year for the costs of the program. By requiring the districts to provide health services, the state has created a mandated program. Furthermore, because the state has limited the amount of the fee that can be charged for such services, districts are eligible for state reimbursement of the costs incurred in providing the health services, after subtracting revenues generated from charging the $15 fee. This reimbursement is estimated to be $1.4 million in 1988-89.

The current $15 maximum health services fee was established in 1981 and has not been increased to reflect the effects of inflation on the costs of providing such services. We estimate that the Implicit Price Deflator for State and Local Purchases of Goods and Services will increase by approximately 36 percent between 1981-82 and 1988-89. Costs associated with the health services program have been subject to similar inflationary pressures.

Based on our review, we conclude that the current limitation on the health services fee (a) constrains the ability of districts to recover the full costs of the health care services program and (b) necessitates a continuation of the state's reimbursement of mandated costs. An elimination of the statutory limit on the health services fee would distribute the costs of the program to those receiving the services--the students, and would eliminate the state's responsibility for reimbursement of the mandated costs. Moreover, this change would be consistent with the state's current policy of funding health service programs at the University of California and the California State University campuses through student fees.

We note that current law prohibits districts from charging students the health services fee if the student is eligible for a waiver of the mandatory enrollment fee due to financial need. Thus, a student already identified as financially needy would *not* be required to pay the higher health services fee. The state would remain liable for reimbursement of such costs.

Reference

State Reimbursement of Mandated Costs: A Review of Statutes Funded in 1988, page 27, January 1989. (Report Number 89-1.)❖

Commission on State Mandates
Funding for State-Mandated Local Programs

Recommendation

We recommend the enactment of legislation to extend the statute of limitations applicable to the state's challenge of mandate findings.

Fiscal Impact

Potential reduction in General Fund costs for reimbursement of mandated local programs.

Analysis

A recent court ruling effectively invalidated the traditional procedure used by the Legislature to override decisions made by the Commission on State Mandates (COSM). In the past, the Legislature has been able to maintain oversight of the commission's decisions through the claims bill process. If the Legislature did not agree with a mandate finding, it amended the claims bill to exclude the appropriation for that mandate. The Legislature has exerted its control over the claims bill in this manner to eliminate millions of dollars in appropriations requested by the commission and its predecessor, the Board of Control.

In a recent decision, *Carmel Valley Fire Protection District v. State of California (Carmel Valley)*, the courts ruled that the state must seek judicial review of a mandate determination in order to challenge a mandate finding. The court also found that a three-year statute of limitations applies to the state's right to seek judicial review of a mandate funding. The three-year period starts with the commission's original finding for a mandate.

The three-year statute of limitations creates problems because, in some cases, the Legislature has not made its determinations as to whether funding is required until more than three years after the date of the mandate finding. Before the Legislature can assess whether to seek judicial review of a mandate finding, it must know which types of costs will be reimbursed and the estimated cost to the state of providing reimbursement. However, the mandate determination process is very time-consuming, and the statute of limitations may, in some cases, expire prior to the time that the claims bill is chaptered.

Analysis CONTINUED

Accordingly, we recommend the enactment of legislation to extend the statute of limitations applicable to judicial review of mandate findings to a period of one year from the effective date of the claims bill which deletes funding for the mandate.

Reference

The 1988-89 Budget: Perspectives and Issues, page 137.❖

Office of Criminal Justice Planning
Allocation of Penalty Assessments

Recommendation

We recommend the enactment of legislation eliminating statutorily required percentage allocations of penalty assessment revenues. Instead, we recommend that penalty assessment revenues be transferred to the General Fund for legislative allocation to programs on the basis of an annual review of program needs during the budget process.

However, because of the constitutional requirement that revenue collected from fish and game violations be used only for fish and game activities, we recommend that penalty assessments derived from this source be transmitted directly to the Fish and Game Preservation Fund, for allocation during the budget process.

Fiscal Impact

No direct fiscal impact. However, adoption of this recommendation would assist the Legislature in (1) making efficient resource allocation decisions and (2) ensuring that fluctuations in penalty assessment revenue would not directly affect expenditure levels for specific programs funded from penalty assessments. In addition, it would provide further assurance that funding levels for individual programs reflect current legislative priorities by allowing the programs financed from penalty assessments to compete for funding with other state programs, such as education, health, and welfare.

Analysis

State law requires that a penalty assessment be levied on most fines, penalties, and forfeitures collected by the courts. The assessment is equal to $7 for every $10 of fine, penalty, or forfeiture collected. These revenues are deposited in the Assessment Fund. Monies in the fund are distributed monthly to seven state special funds, in accordance with formulas specified in law.

Four of the seven funds (Peace Officers' Training Fund, Corrections Training Fund, Local Public Prosecutors and Public Defenders Training Fund, and Fish and Game Preservation Fund) are used to finance training programs for law enforcement. This includes training of peace officers, correctional officers, local public prosecutors and defenders, and fish and game officers. Two of the funds (Restitution Fund and

Victim-Witness Assistance Fund) are used to finance programs that assist victims of crimes. Finally, the Driver Training Penalty Assessment Fund is used to support programs designed to improve driver safety.

The practice of distributing penalty assessment revenues according to statutory percentages results in resource allocations which do not accurately reflect program needs. For instance, between 1983-84 and 1985-86, total revenues allocated to the Corrections Training Fund exceeded program expenditures from the fund by $3.5 million, or 11 percent. On the other hand, the Restitution Fund recently experienced significant revenue shortfalls that resulted in the enactment of urgency legislation (Chapters 1214 and 1232, Statutes of 1987) to increase revenues to the fund.

As these examples indicate, the distribution of penalty assessment resources based strictly on statutory percentages can result in resource allocations which do not accurately reflect program needs. In turn, this may restrict significantly the ability of a program to fulfill its legislative mandate. In addition, dedicating revenues to specific purposes limits the ability of the Legislature to oversee and set priorities for the expenditure of all state funds.

In order to ensure that resources generated by penalty assessments are allocated on a basis consistent with program need, we recommend the enactment of legislation eliminating the current allocation requirements. Instead, we recommend that penalty assessment revenues be transferred to the General Fund for allocation by the Legislature to programs through the annual budget process. However, because of a constitutional requirement that revenue collected from fish and game violations be used only for fish and game activities, we recommend that revenue from this source be transmitted directly to the Fish and Game Preservation Fund, for allocation during the budget process.

Reference

1988-89 Analysis, page 1125.

Penalty Assessments: A Review of Their Use As A Financing Mechanism, January 1988. (Report Number 88-4.)❖

Public Utilities Commission
Regulation of the Trucking Industry

Recommendation

We recommend the enactment of legislation terminating the California Public Utilities Commission's economic regulation of the trucking industry.

Fiscal Impact

No net fiscal effect to the state. Complete deregulation of the trucking industry would result in a reduction of about $18.3 million in regulatory fees, offset by an equivalent savings in the PUC's budget.

Analysis

The California Public Utilities Commission (PUC) regulates "for-hire" commercial trucking companies engaged in *intra*state commerce. It regulates these companies through its authority to (1) approve the rates trucking companies charge businesses to haul goods and (2) issue the certificates and permits needed by the trucking companies to operate. The PUC has no jurisdiction over *inter*state carriers or private "company-owned" trucks.

In April 1986, the PUC ordered an immediate 10 percent increase in all rates, an action which represented a significant increase in the commission's economic regulation of the trucking industry. That action was contrary to the direction of both state and federal regulatory efforts taken throughout the decade. The commission's primary justification for this policy reversal were concerns over a perceived low level of carrier profits and the fear that low profits would have an adverse effect on vehicle and operator safety.

Our analysis indicates that the PUC's economic regulation of the trucking industry is unnecessary. Generally, regulation of an industry is necessary in cases where there is a lack of competition (as with monopolies in the local telephone industry) or where industries would not reflect in market prices the full cost of production (such as pollution costs in the electricity industry). In contrast, the trucking industry is an excellent example of a competitive market: many players, relatively low entry barriers and relatively small economies of scale. In addition, we find no evidence--conceptual or empirical--which indicates that economic regulation leads to improved safety. Economic regulation is an inefficient way to address a problem best solved through *direct* safety requirements and enforcement.

Accordingly, we recommend the enactment of legislation which eliminates the PUC's authority to establish rates and entry requirements in the trucking industry.

Reference

The 1987-88 Budget: Perspectives and Issues, page 221.❖

Personal Income Tax
Depreciation Rules For Residential Rental Housing

Recommendation

We recommend that the Legislature amend the bank and corporation tax law to make the depreciation rules used for residential rental properties the same as those used under the personal income tax laws.

Fiscal Impact

Unknown, probably minor, annual effect on General Fund revenues.

Analysis

For state tax purposes, corporate taxpayers must use a depreciation system (referred to as asset depreciation range--ADR) for residential rental property which is significantly different from the depreciation rules (accelerated cost recovery system--ACRS) that are used by personal income taxpayers for the *same* type of property. In addition, corporate taxpayers with residential rental property generally must use separate depreciation systems for their state and federal tax returns. In its 1987 conformity legislation, the Legislature adopted a general policy of conforming state law to federal law where no good reason exists not to do so.

We see no analytical basis for requiring corporate and personal income taxpayers to use such different rules for depreciating otherwise similar residential rental property. At the same time, we believe that the specified depreciation differences between state and federal law for corporate taxpayers are inconsistent with the Legislature's general policy regarding state-federal tax conformity. Accordingly, we recommend that the Legislature amend the bank and corporation tax law to make the depreciation rules used for residential rental properties the same as those used under the personal income tax law.

Reference

Report on the 1988-89 Tax Expenditure Budget, page 39, December 1988. (Report Number 88-20.)❖

Property Tax
Partial Exemption for Wildlife Habitat Lands

Recommendation

We recommend the enactment of legislation to repeal the partial property tax exemption for certain wildlife habitat lands.

Fiscal Impact

Annual General Fund savings of about $8,000 for school apportionments currently needed to replace property tax losses to school districts in Merced County.

Annual revenue increase of about $13,000 to local governments and special districts (other than school districts) in Merced County.

Analysis

Chapter 1165, Statutes of 1973, established a partial property tax exemption for certain properties that are legally restricted for use as wildlife habitat. In order to qualify, the property must be (1) subject to a contract with a state or federal agency limiting use of the property to wildlife habitat for at least 10 years, (2) at least 150 acres in size, and (3) eligible to receive water from the federal government for waterfowl management purposes. The only properties that meet these qualifications are a number of private duck-hunting clubs in Merced County. The special tax treatment allows the assessed property values for these clubs to be based on the average per-acre sales price of corporate stock or membership shares.

Our analysis of the use of this special tax provision indicates that it is inequitable and probably has little effect on land use decisions. The California Waterfowl Habitat Program established by Ch 633/87 provides a better means of preserving waterfowl habitat in our view. This program allows the Department of Fish and Game to enter into 10-year contracts with duck club owners to maintain existing habitat in exchange for state payments. Because these payments can be targeted at the most critical and threatened habitat lands, they appear to offer a more efficient means of preserving habitat than the partial property tax exemption. Consequently, we recommend enactment of legislation to repeal the partial property tax exemption for wildlife habitat lands.

Reference

Report on the 1988-89 Tax Expenditure Budget, page 63, December 1988. (Report Number 88-20.)❖

Sales and Use Tax
Exemption for Coins and Gold and Silver Bullion

Recommendation

We recommend the enactment of legislation to eliminate the sales and use tax exemption for numismatic coins (which we believe should be defined for tax purposes as coins with a sale price greater than 110 percent of their bullion value).

Fiscal Impact

Unknown increase in sales and use tax revenue, possibly several hundred thousand dollars to $1 million annually, from repealing the exemption on numismatic coins. The state General Fund would receive about 75 percent of this revenue and local governments and special taxing districts would receive the remaining 25 percent.

Analysis

Existing law exempts from the sales and use tax the sale or purchase of coins or gold and silver bullion when the value of the transaction is $1,000 or more. Based on information from the U.S. Mint and industry groups, the coin and bullion market in California appears to involve several hundred million dollars of annual transactions that would be taxable in the absence of the exemption. Bullion and "monetized bullion" coins account for most of the sales. The value of monetized bullion coins (such as the one-ounce gold American Eagle) depends almost entirely on the commodity value of the metal in them. "Numismatic" coins, on the other hand, are collectibles whose value may far exceed the value of their metal content.

Our analysis indicates that, if the sales tax exemption for bullion and monetized bullion coins were eliminated, most of these sales would shift to out-of-state dealers, and the state would therefore collect relatively little in sales taxes on these items compared with the reduction in economic activity that would occur.

Exempting numismatic coins, however, clearly conflicts with the state's general policy of applying the sales tax to other collectibles. In addition, a smaller proportion of sales would be likely to move out of state than would be the case with bullion or monetized bullion coins. Thus, eliminating this exemption probably would result in a net revenue gain to the state and local governments. Based on the size of the coin and bullion market, we estimate that the annual sales tax revenue from sales of numismatic coins could range between several hundred thousand dollars to $1 million.

Accordingly, we recommend the enactment of legislation eliminating the sales and use tax exemption for numismatic coins.

Reference

Report on the 1988-89 Tax Expenditure Budget, page 71, December 1988. (Report Number 88-20.)❖

Sales and Use Tax
Exemption for Packing Ice and Dry Ice Used to Ship Food

Recommendation

We recommend enactment of legislation to repeal the sales tax exemption for ice and dry ice used to pack and ship food for human consumption.

Fiscal Impact

Annual revenues of roughly $800,000 to the state General Fund and $255,000 to local governments and special taxing districts.

Analysis

State law provides a sales tax exemption primarily for ice purchased to pack and ship fresh agricultural produce and fresh fish and seafood. The exemption has been justified on the basis of the following three rationales, none of which are valid in our view.

- ***Equity with non-ice cooling methods.*** This rationale states that "hydrocooling" and other refrigeration services that compete with ice are not directly subject to the sales tax; therefore, ice also should be exempt. This rationale, however, ignores the fact that equipment and supplies used in these competing cooling methods generally are subject to sales tax.
- ***Ice is a "component part" of food.*** This rationale states that ice is necessary to keep produce and seafood fit for consumption and consequently is a "component part" of these foods. Since food generally is exempt from sales tax, packing ice should be exempt as well. Under California sales tax law, however, a "component part" must be *directly incorporated* into the final product. Packing ice does not meet this requirement.
- ***Economic benefits.*** This rationale states that, by reducing costs to California's agricultural and fisheries industries, the exemption holds down consumer food prices and makes these industries more competitive with those of other states and nations. Based on the available evidence, however, it does not appear that the exemption has any significant effect on consumer food prices or the state's competitiveness.

In view of the above, we recommend the enactment of legislation to repeal the sales tax exemption for ice and dry ice used to pack and ship food.

Reference

Report on the 1988-89 Tax Expenditure Budget, page 49, December 1988. (Report Number 88-20.)❖

Senior Citizens' Property Tax Deferral
Fees for Certificates of Eligibility

Recommendation

We recommend the enactment of legislation authorizing counties to charge filing fees to cover their costs of processing liens and certificates of eligibility for the Senior Citizens' Property Tax Deferral Program.

Fiscal Impact

Annual General Fund savings of approximately $230,000.

Analysis

The Senior Citizens' Property Tax Deferral Program allows elderly, blind or disabled Californians with annual incomes less than $24,000 to postpone payment of property taxes on their residences. Those who wish to participate apply to the State Controller, who verifies their eligibility and issues certificates to the participants, which they can use like a check to pay their semiannual property tax bill. County tax collectors are paid by the state for the value of these certificates. The deferred taxes are recorded as a lien against the property and must be repaid to the state with interest when ownership changes.

In addition to the payments for deferred taxes, counties receive about $230,000 annually from the state to reimburse them for mandated administrative costs. These costs include processing the certificates, recording liens, and notifying the state of changes of ownership of properties on which taxes were deferred.

In our view, there is no state interest in funding the mandated administrative costs of this program. The program does not provide low-income assistance per se, but rather allows individuals greater flexibility in paying taxes. Furthermore, fees to offset these costs would be modest (averaging about $9 per participant per tax payment) relative to the program's benefits and, thus, should not significantly deter participation. Consequently, we recommend the enactment of legislation authorizing counties to recover their administrative costs through fees.

Reference

State Reimbursement of Mandated Costs: A Review of Statutes Funded in 1987, p. 19, April 1988. (Report Number 88-9.)❖

State Public Works Board
Augmentation Authority

Recommendation

We recommend the enactment of legislation clarifying the State Public Works Board's authority to augment capital outlay projects.

Fiscal Impact

Potential savings to various funds to the extent that augmentations from state funds are capped at 20 percent of the original appropriation.

Analysis

State law (Government Code Section 13332.11) authorizes the State Public Works Board to, among other things, augment a capital outlay project by up to 20 percent of the amount appropriated by the Legislature for that project. Recently, the board has interpreted this authority as allowing it to make an augmentation of up to 20 percent from one fund even though a project may be funded from two or more funds. This interpretation is not consistent with past practices of the board nor do we believe it is consistent with the expectations of the Legislature when it enacted this section of the Government Code. The result of this interpretation has been to increase the *state's share* of cost of some projects above the 20 percent limitation.

For example, under this interpretation, the board recently used funds from the Special Account for Capital Outlay (SAFCO) to augment projects at the Veteran's Home that were financed by SAFCO and federal funds. While the proposed augmentations were less than 20 percent of the *total* appropriations (that is, combined state and federal funds) for the projects, this action resulted in a *40 percent augmentation of the state's* share of these projects. Prior to approving this augmentation, the Director of the Department of Finance, as required by state law, advised the Chair of the Joint Legislative Budget Committee of his intent to recommend this augmentation for board action (the Director is chair of the board). The Chair of the committee advised the director that the proposed action was not appropriate and should not proceed. Disregarding this response, the director asked for and received board approval of the augmentation.

In view of the board's recent interpretation, we recommend that the Legislature modify Government Code Section 13332.11 to clarify (1) that the board's augmentation authority is restricted to 20 percent of the specific fund from which each item of appropriation is made and (2) that the total appropriations from combined fund sources for a project cannot be used as the base for calculating the allowable augmentation.❖

State Public Works Board

Control of Project Augmentations--
Various Special Funds

Recommendation

We recommend the enactment of legislation requiring the State Controller to provide written assurance that sufficient unencumbered or otherwise unobligated funds are available to support a proposed expenditure or contract obligation before the proposal may be considered by the state Public Works Board (PWB) and before funds can be allocated by the Department of Finance, regardless of existing expenditure authority.

Fiscal Impact

Establishes a procedure to avert overexpenditure of various funds used for capital outlay programs.

Analysis

The Legislature makes appropriations for the state's capital outlay program from various funds. The Public Works Board (PWB) approves and the Director of Finance authorizes expenditures based on these appropriations. In addition, various sections of the Government Code permit the PWB and the director to augment a capital outlay project when, under certain conditions, the estimated cost of the project exceeds the amount appropriated by the Legislature.

Based on our review, we conclude that currently the Department of Finance is not adequately tracking fund balances to assure that PWB augmentations can be supported out of the unappropriated balance available in the respective fund. In a number of instances, this has resulted in deficit spending on the part of the administration. For example, the Governor's Budget shows that the Capital Outlay Fund for Public Higher Education (COFPHE) has a $6.2 million deficit. According to the State Controller, this deficit has resulted primarily from augmentations approved by the board and the department in 1987-88 and 1988-89 which exceeded the unappropriated balance of the fund. The administration has approved a General Fund loan to cover this deficit in the current year. The Governor's Budget proposes to pay back the loan in 1989-90 from the Higher Education Capital Outlay Bond Fund of 1988.

In addition, the Governor's Budget shows a $37 million deficit in the Special Account for Capital Outlay (SAFCO) in the current year. Nevertheless, the board and the department have continued to authorize augmentations from this fund.

In order to improve the fiscal controls over expenditures for state capital outlay projects, we recommend enactment of legislation that would require the State Controller to provide written assurance that sufficient unencumbered or otherwise unobligated funds are available to support a proposed expenditure or contract obligation. Such assurance should be made *before* the proposal is considered by the PWB and before funds are allocated by the Department of Finance. This would require the Controller's Office to track the cash balances of funds (which is currently done) and establish a new system to track *obligations* made against existing cash balances, including appropriations and authorized augmentations (which is not currently done on an ongoing basis). Where availability of revenue to a fund depends on circumstances which may change during the course of the fiscal year (such as bond sales, or tidelands oil revenues), the proposed legislation also would require the Controller to determine whether sufficient revenue will be available to support a proposed PWB action, regardless of the existence of spending authority.❖

Statewide Capital Outlay Master Plan

Recommendation

We recommend the enactment of legislation to require development of a comprehensive statewide capital outlay plan that identifies each state agency's capital needs and financing options over a multi-year planning period.

Fiscal Impact

No direct state fiscal impact. Would provide a more effective decision-making process for (1) financing capital outlay projects and (2) determining priority rankings, as well as appropriate dollar levels, of future bond measures.

Analysis

Currently, the state does not have a comprehensive multi-year capital outlay plan. Instead, there are individual five-year plans in most program areas. As a result, there is no way of identifying, for example, the relative priority of proposed financing measures for various capital outlay projects, what additional financing should be considered or how much money is needed for specific purposes. (In recognition of this problem, the Legislature agreed with the concept discussed below and enacted SB 2214 (Campbell) in 1988. The Governor, however, vetoed the measure.)

In order for the Legislature to make optimal decisions on financing the state's capital outlay needs, it is essential that the decision-making process include a framework for tying together the needs of the various programs of state government. This becomes even more important as financing the state's capital outlay program becomes increasingly dependent on bond measures. As bonds become more of a key element in financing capital outlay, it is critical that the decision-making process be improved so that the state's limited borrowing capacity can be used as effectively as possible.

The cornerstone of this decision-making process is the identification of the state's capital outlay needs and their relative priorities. A comprehensive multi-year capital outlay plan is needed to provide this information. This plan should be based on the capital outlay needs of state programs, and should provide as complete an inventory as possible of current and future capital outlay requirements. This would include all potential future capital outlay projects with the programmatic bases for the project, the estimated cost requirements for each project, relative priority compared to one another and the desired time frame for completion. The minimum time horizon for the multi-year plan should be 5 to 10 years. Ideally, however, it should extend to as many years as necessary to properly prepare the state for its future infrastructure needs.

Once the multi-year plan is available, the Legislature will then have the information it needs to develop a plan to finance its priorities in capital outlay and, where appropriate, craft the proper size of bond issues to present to the voters.

Formulating a multi-year capital outlay plan and using it to develop a schedule of needed financing must involve both the Executive Branch and the Legislature in order to be successful. We believe this would involve two steps, similar to the annual state budget process.

First, the Executive Branch would develop a proposed multi-year state capital outlay plan accompanied by a plan to finance it. This financing plan should include a schedule of future bond sales as well as whatever lease payments, tax increases, user fee charges, and direct appropriations will be needed to pay for future capital outlays. This complete plan should be submitted annually to the Legislature.

Second, the Legislature would review the Executive Branch's capital outlay plan and financing proposal to ensure that they reflect its own priorities and policy views.

Reference

A Perspective on Bond Financing, December 1987. (Report Number 87-16.)❖