

ANALYSIS AND RECOMMENDATIONS WITH RESPECT TO GENERAL CONTROL SECTIONS

The so-called "control sections" included in the 1989 Budget Bill set forth general policy guidelines governing the use of state funds. These sections place limitations on the expenditure of certain appropriations, extend or terminate the availability of certain other appropriations, establish procedures for the expenditure and control of funds appropriated by the Budget Act and contain the traditional constitutional severability and urgency clauses.

The control sections proposed for 1989-90 may be found in Section 3.00 through Section 36.00 of Senate Bill 165 (Alquist) and Assembly Bill 250 (Vasconcellos). In many instances, the numbering of these sections is not consecutive, as the section numbers in the 1989 Budget Bill have been designed to correspond with the equivalent or similar sections in the 1988 Budget Act.

In addition, the Budget Bill includes Sections 1.00, 1.50, 99.00 and 99.50. These are technical provisions relating to the coding, indexing and referencing of the various items in the bill.

Sections Which We Recommend Be Approved

The following sections are virtually identical to the sections in the 1988 Budget Act, or do not represent any change in legislative policy. *We recommend approval of these sections because they are consistent with previous legislative policy.*

Section	Subject Area
3.00	Budget Act Definitions and Statutory Salaries
3.50	Employee Benefits
3.75	Centrex Service Costs
5.00	Attorney Fees—State Courts
5.50	Oversight of Consultant Contracts
6.50	Transfer of Amounts Within Schedules
7.50	Accounting Procedures for Statewide Appropriations
8.50	Appropriation and Control of Federal Funds
8.51	Federal Trust Fund Account Numbers
8.60	Single Audit Review Costs
9.00	Supplemental Report of the 1989 Budget Act
9.20	Administrative Costs for Property Acquisition
11.51	Energy-Related Fund Transfers
12.30	Special Fund for Economic Uncertainties
12.50	Special Fund Reserves
13.00	Legislative Counsel Bureau
22.00	Unallocated Appropriation for Welfare Employment Programs
24.00	State School Fund
24.10	Driver Training
24.60	Lottery Revenues
26.60	Expansion of Satellite Wagering Facilities
27.00	Authorization to Incur Deficiencies
28.00	Authorization for Adjustments in Spending Authority
29.00	Personnel-Years Reporting
30.00	Continuous Appropriations
31.00	Administrative and Accounting Procedures

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- 32.00 Expenditures in Excess of Amounts Appropriated
- 33.00 Governor's Vetoes
- 34.00 Severability of Budget Act Provisions
- 35.00 Budget Act to Take Immediate Effect
- 36.00 Urgency Clause

Sections Which We Recommend Be Modified

We recommend various actions on the following sections:

SECTION 3.60

RECAPTURE OF PUBLIC EMPLOYEES' RETIREMENT SYSTEM (PERS) CONTRIBUTIONS

ANALYSIS AND RECOMMENDATIONS

This section authorizes the Department of Finance (DOF) to (1) recapture any excess funds provided in state agencies' budgets for PERS employer contributions and (2) use these surplus funds to offset employee contributions in the budget year.

Recapture of Overbudgeted Funds Is Appropriate

In 1989-90, as in the current year, there will be excess funds for PERS employer contributions in individual agency budgets for two reasons. First, agency budgets were built using *current-year* employer contribution rates which are generally *higher* than 1989-90 rates recently approved by the PERS Board. Second, certain PERS retirement categories (industrial, state safety and highway patrol) have *surplus* funds in their employer surplus asset accounts.

Surplus assets in the three accounts are estimated to total \$106 million in the budget year. Of this amount, the budget proposes to use \$85 million to offset *state* (employer) retirement contributions in the budget year. In addition, savings from budget-year rate reductions will total approximately \$14 million. The surplus assets and rate reductions are due to an increase in PERS assets, which in turn reduced the system's funding needs. The asset increase is due to greater-than-expected rates of return on employer contributions over the past five years. In addition, the system is still realizing gains from its December 1986 decision to value assets at market rather than book value. The total increase from this change is being phased in over a five-year period.

The reductions to state contributions resulting from both rate reductions and surplus assets would total \$99 million in 1989-90, and we recommend approval of language in the section which would recapture these funds.

Additional Surplus Funds Should Remain in the Account As A "Reserve" To Pay Future State Liabilities

We recommend deletion of language authorizing the use of surplus funds to offset employee retirement contributions because the surplus funds represent earnings on past employer overpayments, and thus, should be used to offset employer (state) contributions in the future.

In addition to reducing *employer* contributions, for the first time, the budget proposes to use surplus funds remaining after the offset of employer contributions to reduce *employee* contributions for Highway

Patrol members. The Department of Finance estimates that there will be \$21.6 million available in the Highway Patrol employer account after fully offsetting employer contributions that could be used to offset *employee* contributions. This use of surplus assets would reduce funds which would otherwise remain in the *employer* surplus asset accounts to help pay future *state* contributions.

Employer surplus funds and contribution rates are recalculated annually, effective each July 1. They are the product of an annual valuation of the retirement fund performed the previous July, and represent consulting actuaries' "best estimate" of the system's funding requirements to pay retirement benefits already earned. While employee contribution rates remain fixed from year to year, employer rates are flexible, reflecting changing estimates of the system's funding needs. Because of the annual fluctuations in employer contribution rates, funds labeled "surplus" really represent past over-estimates of employer funding requirements. The employer (the state) paid more than was necessary to provide for liabilities accrued to date. Consequently, our analysis indicates that it would be appropriate for the employer, not the employee, to realize the benefits of the current surplus. Moreover, due to the ongoing nature of the state's retirement funding requirements, it is short-sighted to give away assets that may be "surplus" to funding requirements at a particular point in time. The state's liability will increase every year, and assets that are surplus today can be used to help pay those obligations in the future.

For these reasons, we recommend deletion of the language authorizing the use of surplus funds to offset *employee* retirement contributions.

SECTION 4.00

HEALTH INSURANCE PREMIUMS

ANALYSIS AND RECOMMENDATIONS

We withhold recommendation on the monthly state contribution rates for employee health insurance specified in this section, pending final determination of the actual increase in health insurance premiums.

This control section, which is identical to Section 4.00 of the 1987 Budget Act, specifies the monthly amounts which the state contributes toward the cost of its employees' and retirees' health insurance. The section provides for state monthly contributions of: (1) \$110 for the employee (or annuitant) only, (2) \$206 for an employee and one dependent, and (3) \$268 for an employee and two or more dependents.

Government Code Section 22825.1: (1) expresses legislative intent that the state pay 100 percent of the *average* premium cost for the coverage of employees and annuitants, and 90 percent of the cost for coverage of dependents, and (2) specifies that the state's contribution toward employee health insurance shall be adjusted in the annual Budget Act. While this code section is "supercedable" under collective bargaining, the Legislature must still approve any change—such as increases in the state's monthly contribution rates—which would result in increased costs during 1989-90.

Changes in the coverage of and premiums for state employee health insurance result from negotiations between Public Employees' Retirement System (PERS) staff and the insurance carriers. These negotiations typically are completed in May. Any changes agreed to must be approved by the PERS board.

ANALYSIS AND RECOMMENDATIONS WITH RESPECT TO GENERAL CONTROL SECTIONS—Continued

At the time this analysis was prepared, there was no basis for determining whether the contribution rates proposed in this section—that is, the current-year rates—are appropriate for the budget year. Accordingly, we withhold recommendation on this section, pending determination of (1) the actual increase in health insurance premiums and (2) rate changes, if any, negotiated under collective bargaining or proposed for nonrepresented employees.

SECTION 4.20

CONTRIBUTIONS TO THE PUBLIC EMPLOYEES' CONTINGENCY RESERVE FUND (PECRF)

ANALYSIS AND RECOMMENDATIONS

We withhold recommendation on the administrative surcharge rate set in this section, pending receipt of updated estimates of budget-year health insurance premiums.

This section was first included in the 1984 Budget Act to provide a mechanism for (1) granting legislative approval of the surcharge rates that state agencies are required to pay (a) for the costs incurred by the Public Employees' Retirement System (PERS) in administering the health benefits program and (b) toward a special reserve in the PECRF; and (2) recapturing excess payments to the PECRF.

This section, as proposed in the 1989-90 Budget Bill, is identical to the version included in the 1988 Budget Act. It proposes to set the administrative surcharge rate for 1989-90 at 0.50 percent of total health insurance premiums and the special reserve rate at 0 percent.

At the time this analysis was prepared, there was no basis for determining the appropriate surcharge rate because a firm estimate of budget-year health insurance premiums was not available. The Department of Finance will not have a firm basis for estimating these premiums until April or May 1989, when the PERS board approves rate increases for its health care providers. Accordingly, we withhold recommendation on this section, pending receipt of updated estimates of 1989-90 health insurance premiums.

SECTION 6.00

STATE BUILDING ALTERATIONS

ANALYSIS AND RECOMMENDATIONS

We recommend a modification to the administration's proposed change to this section in order to maintain consistency between the capital outlay budget process and review of proposed "critical" alterations of state buildings.

This section, which is a long-standing section in the Budget Bill, establishes certain limits on the use of budgeted support funds for alterations of state buildings. From 1980 to 1987, this section provided that departments could not use budgeted support funds to undertake building alterations which cost more than \$10,000 unless the Director of Finance determined that the proposed alteration was "critical." The 1987 Budget Act raised this limit to \$15,000. A "critical" project currently may not exceed \$200,000, and the Department of Finance's determination must be reported to the Chairperson of the Joint Legislative Budget Committee

no less than 30 days prior to the request of bids for the project. Alteration projects which cost less than \$15,000 have not been subject to any approval or reporting requirement.

This year, the administration is proposing to raise the lower limit to \$20,000 and the upper limit to \$250,000. We recommend approval of the administration's proposal to increase the lower level to \$20,000. However, we recommend that the upper limit be maintained at \$200,000, instead of increased to \$250,000. The \$200,000 limit is consistent with the state's definition of minor capital outlay projects. Any capital outlay project which is expected to cost more than \$200,000 is currently considered a major project, and must be considered as a separate item in the Budget Bill. Maintaining the \$200,000 upper limit in this section would ensure that *all* major capital outlay projects continue to receive a similar, higher degree of legislative review, while allowing the administration adequate flexibility in "critical" situations.

SECTION 9.10

FINAL CHANGE BOOK

ANALYSIS AND RECOMMENDATIONS

We recommend that this section be deleted.

This section states that the Final Change Book, which contains the list of changes to the 1989-90 Governor's Budget, reflects the actions of both the Legislature and the Governor in enacting the Budget Act of 1989. It also provides that the Department of Finance shall transmit the Final Change Book to all agencies.

The 1988 Budget Bill, as introduced, contained this same provision. In acting on the Budget Bill, the Legislature deleted the section because of a concern that its adoption could imply legislative approval of actions taken by the Governor subsequent to passage of the budget by the Legislature.

The deletion of this section would be consistent with the past expression of legislative policy on this issue.

SECTION 11.50

DISTRIBUTION OF TIDELANDS OIL REVENUES

ANALYSIS AND RECOMMENDATIONS

We withhold recommendation on the proposed distribution of tidelands oil revenues, pending (1) legislative action on the spending proposals in the Budget Bill and (2) a report from the Department of Finance concerning funding of the state's share of federal flood control projects.

We further recommend that the Department of Finance submit to the Legislature, prior to budget hearings, the department's plan to meet current-year obligations of the Special Account for Capital Outlay, in view of a projected deficit.

This section would modify existing law governing the allocation of tidelands oil revenues for the budget year. Table 1 compares the allocation of these revenues under existing law with the allocations proposed in this section.

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Table 1
Distribution of 1989-90 Tidelands Oil Revenue
Comparison of Current Law with Section 11.50
(dollars in thousands)

<i>Fund</i>	<i>Current Law</i>	<i>Section 11.50</i>
State Lands Commission	\$12,388	\$12,388
California Water Fund	25,000	—
Fisheries Restoration	—	—
Central Valley Project	5,000	—
Sea Grants	525	—
Capital Outlay Fund for Public Higher Education (COFPHÉ) ..	7,087	—
State School Building Lease Purchase Fund (SSBLPF)	—	—
Energy and Resource Fund (ERF)	—	—
Housing Trust Fund	—	—
Special Account for Capital Outlay (SAFCO)	—	37,612
Total	\$50,000	\$50,000

Until the Legislature has determined how it wants to spend these revenues, it would be premature to allocate these revenues through Section 11.50. Once the spending decisions have been made, revenues should be allocated in a conforming manner.

California Water Fund. In our analysis of Item 3860-301, we note that the state is legally obligated to pay, in 1989-90, \$10.5 million in nonfederal costs of five federal flood control projects or to pay \$800,000 in interest penalties on the delinquent payments. In past years, the state's share of similar projects has been funded through a distribution of tidelands oil revenue to the California Water Fund. The administration, however, has not requested a distribution of tidelands oil revenues in 1989-90 to meet either the project costs or the interest penalties. Moreover, the administration has not proposed an alternative funding source. Consequently, we have recommended that the administration report during budget hearings on how it intends to fund either the project costs or the interest penalties.

Special Account for Capital Outlay. The budget indicates that the Special Account for Capital Outlay (SAFCO) will end the current year \$36.8 million in deficit. The budget requests \$37.6 million from the tidelands oil revenues for SAFCO, in order to meet existing obligations of \$36.8 million, permit appropriation of \$300,000 for project planning for 1990-91 and 1990-92, and leave a reserve of about \$500,000 at the end of 1989-90.

Our analysis indicates that the *existing obligations* of SAFCO alone are \$38 million, or \$0.4 million higher than the total proposed allocation. Consequently, if the department intends to cover existing obligations (\$38 million) and pay for project planning (\$0.3 million), our analysis indicates that SAFCO would end the budget year with a deficit of about \$700,000.

The primary reason for the current-year deficit in SAFCO is that tidelands oil revenues for the current year are now anticipated to be \$34.4 million *less* than provided in the 1988 Budget Act. In addition, the Public Works Board (PWB) authorized about \$1.5 million of project augmentations from SAFCO in the first five months of 1988-89. The Department of

Finance authorized expenditure of these augmentations, although the obligations of SAFCO which existed at the time already exceeded the budgeted allocation of tidelands oil revenues to the fund. This action on the part of the department and the PWB reinforces our conclusion, stated in our analysis of Item 9860-302-785, that the Department of Finance is not adequately tracking fund balances to assure that proposed new obligations on a particular fund can be supported from the unappropriated balance available in that fund. In our analysis of that item, and in our report, *Summary of Recommended Legislation*, we propose legislation which would address this problem. We also recommend that the Department of Finance submit to the Legislature, prior to budget hearings, the department's plan to meet SAFCO obligations in the current year, in view of the projected deficit.

In addition, the price of oil has risen slightly since the State Lands Commission's latest estimate of tidelands oil revenues for the current and budget years. The commission expects to release a revised revenue estimate in February. This revised estimate, coupled with the department's plan for SAFCO and its report on funding the state's share of federal flood control projects, should give the Legislature the information it needs to determine a spending plan for tidelands oil revenues for the budget year.

SECTION 11.70

TRANSFER OF 8(g) MONIES TO GENERAL FUND

ANALYSIS AND RECOMMENDATIONS

We recommend the adoption of Control Section 11.70 to transfer \$8 million from the Outer Continental Shelf Land Act Account (federal "8(g)" funds) to the General Fund, to the extent that these funds are not appropriated for infrastructure grants and loans to rural communities.

The budget requests the transfer of \$8 million from federal 8(g) funds to the Rural Economic Development Fund to support additional grants and loans for the Rural Economic Development Program (REDIP) within the Department of Commerce. This program is intended to provide assistance to rural areas in financing infrastructure projects. These projects may help rural areas to retain, expand or attract businesses, thereby creating jobs and improving local economic conditions (please see Item 2200).

As we indicate in our analysis of the Department of Commerce, the department is unable to demonstrate a need for additional funds beyond those which are now available. Furthermore, sufficient funds are available for additional applications beyond those projected by the department. On this basis, we recommend in our analysis of the department's budget that further funding for the program await the identification of additional applicants. In order to make these funds available for other General Fund purposes, we recommend the adoption of the following control language:

SEC. 11.70. On or after July 1, 1989, the State Controller shall transfer eight million dollars (\$8,000,000) from the Outer Continental Shelf Land Act Account to the General Fund.

ANALYSIS AND RECOMMENDATIONS WITH RESPECT TO GENERAL CONTROL SECTIONS—Continued

SECTION 12.00

APPROPRIATIONS LIMIT FOR 1989-90

ANALYSIS AND RECOMMENDATIONS

We withhold recommendation on this section, pending the receipt of final data on the factors used to adjust the state's appropriations limit.

This section establishes the state's 1989-90 appropriations limit called for by Article XIII B of the State Constitution. It also sets a time limit on judicial challenges to the limit established by this section.

The budget proposes a 1989-90 limit of \$29,184 million. This is only a preliminary estimate of the limit because the limit's annual adjustment factors for inflation and population will not be final until May.

When these data become available, we will report our recommendations on the state's appropriations limit to the Legislature.

Part Four of *The 1989-90 Budget: Perspectives and Issues* contains a discussion of the state's appropriations limit and its effect on state fiscal and program decision-making.

SECTION 12.31

EDUCATION CONTINGENCY EXPENDITURES—PROPOSITION 98 RESERVE

ANALYSIS AND RECOMMENDATIONS

We recommend that, at the time of the May Revision, the Legislature amend Control Section 12.31 to (1) reduce the size of the K-12 education reserve to \$100 million, because this amount will be adequate to protect against likely deficiencies and (2) eliminate the proposed \$10 million community college reserve, because the community colleges—by definition—cannot incur deficiencies. We further recommend that the Legislature appropriate the balance of the Proposition 98 reserve for designated, high-priority educational purposes.

The Governor's Budget proposes a total of approximately \$400 million in expenditures above minimum statutory requirements for K-12 schools and community colleges, in compliance with the requirements of Proposition 98 of 1988 (the "Classroom Instructional Improvement and Accountability Act"). Of this amount, \$230 million is appropriated in Control Section 12.31, "... for subsequent appropriation by the Legislature to augment the Department of Education Item 6110-198-001 (\$220,000,000) and the California Community Colleges Item 6870-198-001 (\$10,000,000) for deficiencies and other educational purposes."

Our analysis indicates that, based on the historical level of actual K-12 education deficiencies, a funding level of \$100 million would be entirely adequate for this purpose. Moreover, no community college reserve is needed, because the level of funded enrollment is "capped" and—by definition—deficiencies cannot occur.

If \$100 million is set aside in this Control Section for deficiencies, then the remaining \$130 million can be appropriated in the 1989 Budget Act to meet high-priority K-12 education and community college expenditures designated by the Legislature. We caution that this figure of \$130 million will change (1) as a result of legislative actions to shift funds between individual education budget items and the Proposition 98 reserve and (2) when the Department of Finance presents its estimates of General Fund

revenues at the May Revision. Accordingly, we recommend that, at that time, the Legislature amend Control Section 12.31 to retain \$100 million as a reserve against K-12 funding deficiencies and appropriate the balance for designated, high-priority educational purposes.

This issue is discussed in greater detail in Items 6110-198-001 (Department of Education) and 6870-198-001 (California Community Colleges).

SECTION 18.10

DEPARTMENT OF PARKS AND RECREATION—CONTRACT AGREEMENTS

ANALYSIS AND RECOMMENDATIONS

We recommend the restoration of this control section to continue in force legislative oversight of proposed operating agreements with local agencies.

Many state park units are operated and maintained by local agencies through operating agreements with the Department of Parks and Recreation (DPR). Since 1972, every Budget Act has included a control section prohibiting the DPR from approving or modifying any operating agreement unless either (1) the Legislature has reviewed and approved the agreement during the budget process or (2) the Public Works Board (a) determines that the agreement could not have been reasonably presented to the Legislature during the budget process, (b) approves the agreement, and (c) the Director of Finance has notified the Chairs of the Joint Legislative Budget Committee and the fiscal committees 20 days in advance of board consideration of the agreement. In addition, the control section requires the DPR to include with its proposed agreements an identification of anticipated state costs and revenues related to each proposal. (Earlier versions of this section also provided for similar legislative review of proposed concession agreements and operating leases, but these provisions have since been codified in the Public Resources Code.)

The Budget Bill does not include this control section for 1989-90. We believe the section provides necessary legislative oversight of the DPR's proposed budget-year operating agreements. Consequently, we recommend that the Legislature restore the prior years' Budget Act Section 18.10 as follows:

SEC. 18.10. (a) No expenditure from an appropriation made by this act to the Department of Parks and Recreation shall be made to modify, execute, or approve an operating agreement with any local entity or any nonprofit corporation, unless either of the following has occurred:

(1) The Legislature has reviewed the agreement as part of the support or capital outlay budget of the Department of Parks and Recreation and has expressed approval, through the supplemental language report, of the expenditure from an appropriation made by this act.

(2) The State Public Works Board has approved the agreement not sooner than 20 days after the Director of Finance has provided written notification to the Chairperson of the Joint Legislative Budget Committee and the chairperson of the committee in each house that considers appropriations, and upon a determination by the board that the proposal could not have reasonably been presented to the Legislature through the annual budget process.

(b) The Department of Parks and Recreation shall include with the proposed agreement sufficient documentation to enable the Legislature, or the board, as the case may be, to evaluate fully the estimated operating costs and revenues and all terms upon which the agreement is proposed to be entered

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into. Specifically, the documentation shall identify (1) any anticipated costs to the state for operation or development under the agreement and the anticipated state share of total operation and development costs and (2) the anticipated annual revenues, net of operation costs, for the unit or portion thereof and the state share of these revenues.

SECTION 23.50

ALLOCATION OF FEDERAL IMMIGRATION REFORM MONIES

ANALYSIS AND RECOMMENDATIONS

We recommend that Section 23.50 be modified to reflect the actions taken by the Legislature to the various support items of the Budget Bill.

This section appropriates federal funds made available under the federal Immigration Reform and Control Act (IRCA). This act authorized a general amnesty for certain groups of undocumented aliens, holding out eventual citizenship to these individuals.

The IRCA legislation included \$4 billion in federal funds to pay for the cost of certain state and federal services that would be available to legalized aliens. A portion of these funds—known as State Legalization Impact Assistance Grants (SLIAG) funds—are generally available from 1987-88 through 1991-92.

The 1989-90 Governor's Budget proposes through this section to spend \$552 million in federal SLIAG funds to reimburse state and local programs for the cost of providing services to eligible legalized aliens. The Budget Bill also includes these appropriations in the schedules of each department that receives SLIAG funds.

We review the SLIAG funding proposal and the issues it raises in *The 1989-90 Budget: Perspectives and Issues*. In addition, we discuss several issues related to SLIAG in detail in our reviews of various departmental budgets. Specifically, in the analysis of the Department of Health Services (Item 4260), we review the policy issues regarding the Governor's proposal to substantially increase SLIAG funding for the medically indigent services program. We also address questions regarding the estimates for the perinatal, adolescent family life, and California Children's Services programs, and we discuss a court injunction that limits the department's ability to claim SLIAG funds for some Medi-Cal services. In the analysis of the State Department of Education (Item 6110), we address policy questions regarding the administration's proposals to target SLIAG funding to critical educational services.

We recommend that this section be modified to reflect the actions taken by the Legislature in the various support items of the Budget Bill.