

Background

The California Department of Transportation's (Caltrans') Capital Outlay Support (COS) program provides the support necessary to deliver highway capital projects. The department works on roughly 2,000 transportation projects throughout the state each year. Work conducted in the program includes completing environmental reviews, designing and engineering projects, acquiring rights of way, and managing and overseeing construction. The department accomplishes about 90 percent of its COS work with state staff, and about 10 percent of work with private consultants.

Budget Request. The Governor's May Revision requests \$1.9 billion (from various transportation special funds) for the COS program. The amount includes about \$1.7 billion for 10,756 full-time equivalent (FTE) positions for the COS program, and \$200 million for the program's share of Caltrans administration. The request is 122 position equivalents higher than proposed in the January 10 budget, but is roughly the same level as the 10,822 position equivalents budgeted for the program in the current year. The proposal maintains an efficiency reduction that was enacted in the current year to reduce the size of the program, which was budgeted for 11,500 position equivalents in 2009-10.

Prior LAO Concerns Regarding the COS Budget. In our *Analysis of the 2010-11 Budget Bill* we found that Caltrans' requests for funding and staffing of the COS program lacked workload justification. We recommended that the Legislature require Caltrans to provide additional information to justify its annual COS budget, have Caltrans report on the steps it is taking to control its COS costs, request an audit of the program's time-charging practices, and reduce the program staffing by 1,500 and \$200 million a year to better align the program with its actual workload.

In order to obtain better information regarding the COS budget, the Legislature requested an audit of the program and established further Caltrans reporting requirements in Chapter 6, Statutes of 2011 (AB 105, Committee on Budget). Under the provisions in Chapter 6, beginning with the 2011-12 budget, the department is required to provide specific information to justify the budget amount requested for the COS program on an annual basis. The results of the Bureau of State Audits' (BSA) evaluation of the program were released in early May 2011.

Caltrans Is Making Progress, but More Work Is Still Needed

As described in more detail below, Caltrans is making progress in its efforts to provide justification for its COS budget. However, concerns raised by the BSA about the quality of Caltrans' data hampers our ability to evaluate the 2011-12 budget request. We will continue to work with Caltrans to better understand how it develops its COS budget, which will hopefully inform the Legislature's future budgeting decisions.

Significant Step Towards Transparency and Accountability. As noted above, Chapter 6 requires Caltrans to provide specific data to the Legislature to support its COS budget request. This information was provided to the Legislature in early May 2011. We view this as a significant step toward transparency and accountability in the COS budget. For example, the data includes a list of roughly 2,000 projects that Caltrans plans to work on in 2011-12, the number of staff positions requested for each project, and the dollar amount of each project's support budget. According to Caltrans, this is the information it uses to determine its staffing needs for the COS program. Overall, we found that the type of information and the framework in which it was

provided is consistent with the requirements of Chapter 6, and will be useful in evaluating the level of resources requested each year for the COS program.

Concerns Have Been Raised About Quality of Data. Our analysis found that while the information Caltrans provided meets the Chapter 6 requirements, the quality of some of the data is questionable. The recent audit by BSA raised questions about the quality of Caltrans' COS budget data. The audit found that:

- Caltrans has done little analysis to determine the frequency or magnitude of support cost budget overruns.
- Its systems contain inaccurate budget data.
- Caltrans does not have a process for centrally tracking projects' total support budgets.
- Its time-reporting system lacks strong internal controls.
- Better project monitoring could help minimize support cost overruns.

For example, BSA found that many Caltrans projects were being implemented with support budgets based on out-of-date staffing cost estimates. Specifically, although Caltrans engineers received a 40 percent increase in pay in recent years, this higher pay rate was not factored into the planned support costs on projects. In response to the BSA audit, Caltrans has acknowledged problems with the quality of its current COS data.

We asked Caltrans if the department had updated its project budgets to address the BSA's issues prior to developing its 2011-12 budget request and the supplemental budget information provided to the Legislature in early May. The department indicated that the budget request and supporting data were not changed to address concerns raised by BSA's audit.

Lack of Good Data Hampers Analysis. Concerns about the quality of the data used to support the 2011-12 budget request hamper the Legislature's ability to conduct a meaningful analysis of the COS budget request at this time. For example, we found that Caltrans is requesting resources to work on 257 projects that have already exceeded their support budgets by a total of \$590 million. Given the BSA's findings that 40 percent increases in pay in recent years had not been appropriately built into COS support budgets, we expected that some cost overruns would be evident in the data. However, the cost overruns were much greater than that in some cases. Fifty-three of these 257 projects, accounting for \$366 million or 68 percent of the cost overruns, have exceeded their support budgets by 100 percent or more. We asked the department for justification for providing additional staff resources to work on projects that are already substantially overbudget, and what specific resources it has identified to fund these additional project costs. However, Caltrans staff has neither provided a rationale for the cost overruns on these substantially overbudgeted projects nor identified how it plans to pay for these cost overruns.

At this time, we are still working with Caltrans to better understand how it develops its estimate of the level of staff resources needed to deliver individual projects. Because, as the BSA audit noted, Caltrans does not track this information centrally at headquarters, we expect this to be an iterative process that will require analysis of individual project budgets, requests of specific information from district offices, and, in all likelihood, meetings with district staff. We expect this process will likely not be completed before this fall, but anticipate that it will provide

useful information about the COS budget that we think will be helpful to the Legislature in its future budgeting decisions.

Analysis of Governor's Proposal

As described in more detail below, the Governor's proposal keeps COS resources at essentially the same level as in the current year despite declining workload in the program. The proposal partly addresses concerns about the COS program's declining workload by proposing that a slightly higher percentage of work be performed by private consultants, who are easier to terminate than state staff when workload declines. While we agree in concept with the idea of using a greater level of contracting as a tool to provide Caltrans more flexibility, we have some concerns about the administration's specific budget proposal. Our analysis indicates that Caltrans' COS workload estimates are overly optimistic in regard to the funding available for projects and that the Governor's proposal may not provide enough flexibility to Caltrans to manage its declining workload. In addition, our analysis indicates that the budget inappropriately funds work on some local projects with state transportation funds. We discuss these issues in more detail below.

Governor's Proposal Keeps Resources Relatively Flat, Despite Decline in Workload. The Governor requests \$1.9 billion to fund 10,756 FTEs and the administrative costs for the COS program. The FTEs requested for 2011-12 include 9,120 state staff, 398 FTEs of planned overtime expenditures, and 1,238 private consultants. As described earlier, this would keep the level of resources requested relatively flat in the budget year.

However, Caltrans' most recent five-year estimate of its COS workload shows that Caltrans expects workload to decline slowly in the budget year and each of the four years after that. The projected workload decline is mainly due to the spend-down of temporary funding sources, such as Proposition 1B bond funds and federal stimulus funds provided by the American Recovery and Reinvestment Act (ARRA).

For example, Caltrans' COS staffing was increased in the past in order to deliver projects in the Proposition 1B bond programs. However, the workload related to the Proposition 1B programs is projected to drop as many of these projects are completed over the next several years. Caltrans is currently estimating that it will spend roughly \$2.5 billion on Proposition 1B projects in the first half of 2011-12 but only \$530 million for the second half of the year. We are still reviewing whether Caltrans has fully accounted for this dramatic workload decline in the department's budget request and longer-term workload estimate.

Similarly, in recent years, the Legislature had increased Caltrans COS resources for the delivery of ARRA projects. However, the one-time infusion of \$2.6 billion from ARRA for transportation projects must be fully spent by September 30, 2015. As this deadline approaches and projects are completed, Caltrans' COS workload for ARRA projects will taper off and come to an end.

Workload Estimates Are Based on Overly Optimistic Federal Funding Assumptions. Our review of Caltrans' five-year workload estimate finds that some of the department's assumptions about future workload are likely overly optimistic in regard to the availability of funding for transportation projects. Specifically, Caltrans assumes that ongoing federal transportation funding will increase over the next five years. However, the federal transportation policies currently being debated by Congress would not provide an increase in funding. In fact, Congress

is considering significantly reducing the amount of federal transportation funding provided in the next transportation act (which is planned to cover a six-year period). If federal funding remains flat or declines from current levels, then Caltrans' workload would drop at an even faster rate than the department is currently forecasting.

Governor Proposes to Utilize a Slightly Higher Proportion of Consultants. The Legislature has historically budgeted the COS program to perform 90 percent of its workload with state staff and 10 percent through contracts with private consultants. For 2011-12, the Governor is proposing to slightly increase the proportion of workload performed by private consultants to 11.5 percent of total workload. The administration cites the temporary nature of much of the current workload as the reason for relying more on private consultants. The administration's rationale is that contracts with private consultants are relatively easy to terminate as workload declines, while Caltrans would have to go through a lengthy and expensive layoff process in order to reduce the size of its workforce.

Governor's Proposal Partly Addresses Declining Workload Trend. We think the Governor's proposal to use a larger percentage of private consultants for COS workload in 2011-12 makes sense in concept because it would provide Caltrans with greater flexibility to manage the decrease in workload and avoid future layoffs of Caltrans staff. This approach is consistent with one of the recommendations from the BSA audit that Caltrans not hire more permanent state staff than it needs and that the Legislature consider appropriating funding for consultants to address temporary increases in Caltrans' workload. Based on our analysis above, we think it is likely that the COS workload will decline even faster than the department currently anticipates. Relying on consultants for 11.5 percent of the workload, as the Governor has proposed, may not be enough to adequately address the decline that is likely to occur in Caltrans' COS work.

Request Inappropriately Funds Local Projects From State Highway Account (SHA). A portion of the budget request for the COS program is for state resources to work on projects where a local agency, such as the Los Angeles County Metropolitan Transportation Authority, is the lead on the project rather than the state. For these projects, Caltrans is hired by that local agency to perform project support work, such as environmental review, design, right-of-way acquisition, and construction management. According to Caltrans, department policy is that it is to be reimbursed by the local agency for such work, since such projects are a local financial responsibility.

Despite Caltrans' stated reimbursement policy, our analysis indicates that the budget requests funding to support 430 FTEs at a cost of about \$70 million from a state funding source—the SHA—to perform support work on local projects. We have asked Caltrans why the budget proposes to fund these resources from the SHA rather than from local reimbursements. At the time our analysis was prepared, Caltrans had not provided a response.

LAO Recommendations

Clearly, some level of resources must be provided for the COS program in 2011-12 so that important state transportation projects can move forward without unnecessary delay. However, it is not possible at this time to determine if the level of resources requested in the Governor's May Revision budget plan for 2011-12 is the right amount, given the problems identified in (1) the quality of the data used to support the 2011-12 budget request and (2) the likelihood that the COS workload estimates are based on overly optimistic estimates of the funding available for

transportation projects. Below, we outline what we believe is the best approach to navigating these difficulties.

Approve Overall Budget Level. Because of the concerns identified above and the length of time it will take Caltrans to obtain information from district offices that would ensure that the Legislature gains a better understanding of how the COS budget request is developed, we are unable to fully evaluate the 2011-12 COS program request and determine if the level of resources requested is appropriate. We are continuing to work with Caltrans to understand its COS budget data, but we expect that this process will take until at least the fall of this year. Absent better information regarding the program's budget and workload, therefore, we recommend the Legislature approve the overall level of COS resources that the Governor has requested in the May Revision. However, as described below, we recommend two changes to the mix of resources requested.

Give Caltrans Flexibility to Use Higher Percentage of Private Consultants. As noted above, Caltrans' COS workload is expected to decline each year for at least the next five years beginning in 2011-12. However, the state's processes for managing the size of the workforce do not necessarily give the department the tools we think it will need to reduce the size of its state workforce. A greater use of private-sector consultants could allow Caltrans to more effectively manage its declining workload. Specifically, as COS positions in various districts become vacant, we think Caltrans would benefit from the flexibility to fill those vacancies with either a state worker or a private-sector consultant depending on future expected workload. This would allow Caltrans to avoid laying off state staff in the future, yet provide sufficient resources to complete the work it currently has to perform. Thus, we recommend that the Legislature modify the proposed budget bill language for the Caltrans budget Item 2660-001-0042 to allow Caltrans to use consultants for *up to* 20 percent of their COS workload in 2011-12. Our approach would not result in the layoff of current state workers.

Technical Correction for Reimbursement Work. As noted in our analysis above, Caltrans has requested about \$70 million from the SHA for the support of 430 FTEs to perform COS work on some local projects. Funding such local work from state transportation accounts is inconsistent with Caltrans policies and, absent some explanation from Caltrans, appears to be an inappropriate use of state funds. We recommend that the Legislature approve a technical adjustment to decrease the funding for COS activities supported from the SHA by 430 FTEs (about \$70 million) and increase reimbursement funding by an equivalent amount.