STATE ADMINISTRATION

MAJOR ISSUES (February 1994)

%***Reform the Judges' Retirement Program.*** We recommend enactment of legislation to create a less costly retirement benefit plan for *new* judges that will be fully funded on an actuarially sound basis. We also recommend enactment of legislation that reduces the General Fund cost of the existing judges' retirement system. Recommended changes would save the General Fund $6.5 million in 1994-95 and increasing amounts in future years. (See page H-36.)

%***Legislature's Options Regarding State Employee Pay Increases.*** The Legislature has four basic options in approaching the proposed increases: (1) approve as budgeted, (2) fully fund the pay increases, (3) require all departments to absorb the increases, and (4) cancel or reduce the size of the increase. Given the state's current fiscal situation, we believe the last of these options is the most appropriate. (See page H-32.)

%***Performance Budgeting Pilot Project Faltering.*** The budget reflects minimal progress in implementing the Governor's pilot project and does not recognize the significant costs necessary to implement it. We recommend that the Department of Finance provide the Legislature with more detailed information regarding its plans for the project. (See pages H-22 to H-26.)

%***Teale Data Center's Fiscal Stability Jeopardized by Problems.*** We have found a number of serious deficiencies in the center's operations related to procurement, fiscal management, and compliance with state laws and procedures. We recommend a number of steps to correct the problems. (See pages H-110 to H-117.)

%***Disaster-Related Information Remains Elusive.*** It is difficult for the Legislature to obtain comprehensive information on current and prior disasters. We recommend that the Legislature direct the Office of Emergency Services to develop systems that will provide more information on the status of disasters, as well as information on disaster-assistance programs. (See page H-124 to H-127.)

%***Victims of Crime Program Experiences Continued Funding Shortfalls.*** Even if the Legislature approves the significant augmentations to the program proposed by the Governor, the program will still have a shortfall of at least $8 million in the budget year. We offer several alternatives to bring resources and expenditures for the program in line. (See page H-129.)

STATE ADMINISTRATION

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STATE ADMINISTRATION

OVERVIEW

Funding for state administration is proposed to decrease in the budget year due to a combination of factors, including a decrease in the cost of employee compensation and reductions in local government aid related to an offset for property tax transfers in the current year and enhanced property tax administration.

The budget proposes total expenditures for state administration of $5.6 billion in 1994-95, a decrease of about $755.8 million, or 14 percent, below estimated current-year expenditures. Proposed General Fund spending for state administration is $2.2 billion, or 5.8 percent of all General Fund expenditures proposed in the Governor's Budget for 1994-95.

Figure 1 shows that expenditures for state administration (all state funds) have fluctuated within the range of $4.3 billion and $6.3 billion during the eight-year period from 1987-88 through 1994-95. When adjusted for inflation, total spending for state administration has increased slightly, 4.7 percent, since 1987-88. The General Fund expenditures have declined 22 percent over the same period when adjusted for inflation.

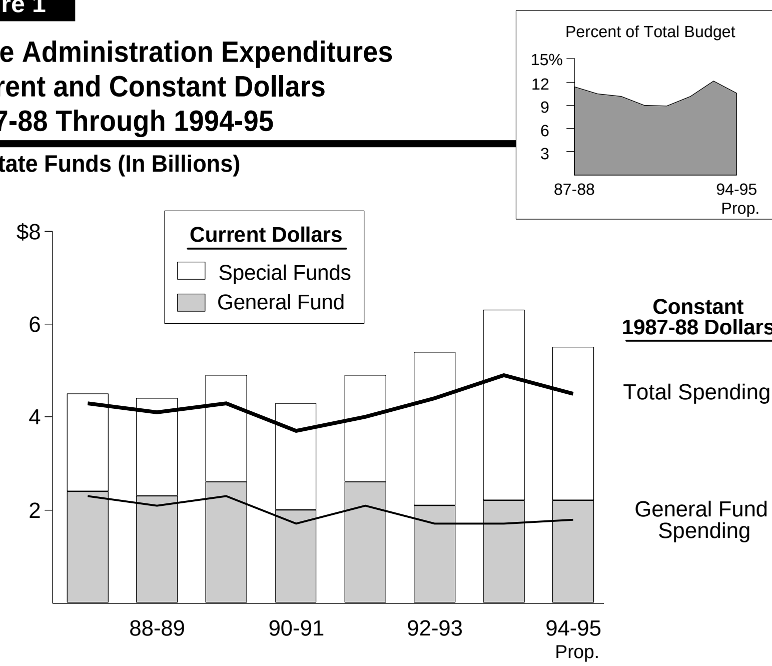
SPENDING BY MAJOR PROGRAMS

Figure 2 shows state expenditures for nine major administration programs in 1992-93 and 1993-94, and as proposed for 1994-95. The Department of General Services, while not included in Figure 2, is projected to spend $126.3 million in 1994-95 on state administration, an increase of $3 million, or 2.4 percent, over estimated current-year expenditures.

Figure 1

State Administration Expenditures Current and Constant Dollars 1987-88 Through 1994-95

All State Funds (In Billions)



Local Government Aid. The largest program in state administration is the shared revenues program, which distributes state-collected revenue to local government agencies. The $49 million decrease in spending primarily reflects a decrease of $114 million in Motor Vehicle License Fund (VLF) apportionments to local governments, offset by growth in sales tax-generated funds for local public safety. The decrease in VLF apportionments is primarily the result of eliminating in 1994-95, $130 million in apportionments which were made available, one a one-time basis, in the current year to partially offset the 1993-94 transfer of property tax revenues from cities and counties to school and community college districts.

The state provides local property tax relief, both as subventions to local governments and as direct payments to eligible taxpayers, through seven tax relief programs. The two largest are the Homeowners' Property Tax Relief (Homeowners' Exemptions) and Renters' Tax Relief (Renters' Credit) programs. The budget proposes a $49 million net

Figure 2

State Administration Budget Summary[a,b]
1992-93 Through 1994-95

(Dollars in Millions)

	Actual 1992-93	Estimated 1993-94	Proposed 1994-95	Change From 1993-94 Amount	Change From 1993-94 Percent
Shared Revenues					
General Fund	$0.2	$0.3	$0.3	—	—
Special Funds	2,158.7	3,637.0	3,587.9	-$49.1	-1.4%
Totals	**$2,158.9**	**$3,637.3**	**$3,588.2**	**-$49.1**	**-1.3%**
Tax Relief					
General Fund	**$806.9**	**$487.0**	**$437.9**	**-$49.1**	**-10.1%**
Contributions to Teachers' Retirement Fund					
General Fund	**$691.0**	**$758.3**	**$818.3**	**$60.0**	**7.9%**
Health Benefits for Annuitants					
General Fund	**$292.7**	**$316.6**	**$329.1**	**$12.5**	**3.9%**
Augmentation for Employee Compensation					
General Fund	$8.4	$110.7	$43.9	-$66.8	-60.3%
Special Funds	6.3	50.2	5.1	-45.1	-89.8
Totals	**$14.7**	**$160.9**	**$49.0**	**-$111.9**	**-69.5%**
Transfers to Public Employees' Retirement Fund					
General Fund	—	—	$134.3	$134.3	—[c]
Special Funds	$197.6	$225.9	229.0	3.1	1.4%
Totals	**$197.6**	**$225.9**	**$363.3**	**$137.4**	**60.8%**
Payment of Interest on General Fund Loans					
General Fund	**$184.6**	**$330.0**	**$330.0**	—	—
Board of Equalization					
General Fund	$140.5	$156.5	$161.8	$5.3	3.4%
Special Funds	29.0	12.7	13.7	1.0	7.9
Totals	**$169.5**	**$169.2**	**$175.5**	**$6.3**	**3.7%**
Franchise Tax Board					
General Fund	$210.6	$250.4	$258.5	$8.1	3.2%
Special Funds	0.9	7.8	8.3	0.5	6.4
Totals	**$211.5**	**$258.2**	**$266.8**	**$8.6**	**3.3%**

[a] Excludes reimbursements, revolving funds, and other nongovernmental cost funds.

[b] Detail may not add to totals due to rounding.

[c] Not a meaningful number.

decrease in spending for tax relief programs from $487 million in 1993-94 to $438 million in the budget year. This change primarily is due to elimination of (1) the Renters' Tax Relief program (The 1993-94 budget contained $30 million for payment of prior-year claims) and (2) a proposal in the current year to provide $25 million to counties on a one-time basis for property tax administration enhancements.

The Governor's Budget also proposes a state/county restructuring which would (1) shift $1.1 billion in property taxes from schools and community college districts to the counties, (2) provide counties with $2.1 billion in state sales tax revenue and other resources, and (3) shift approximately $3.2 billion in program costs from the state to the counties. We discuss this proposal in detail in *The 1994-95 Budget: Perspectives and Issues.*

Interest. To meet the General Fund's short-term cash needs, the state may borrow either internally, from the balances in other state funds, or externally by issuing short-term borrowing instruments such as revenue-anticipation notes. Payment of interest on General Fund loans is expected to remain the same in the budget year as in the current year—$255 million from internal sources and $75 million from external sources.

Retirement. The budget projects a General Fund transfer to the Public Employees' Retirement System (PERS) in 1994-95 of $134.3 million for the state's retirement contribution for its 1992-93 payroll. The General Fund contribution is based on the 1992-93 payroll pursuant to the provisions of Ch 71/93 (SB 240, Committee on Budget and Fiscal Review). Under the provisions of Ch 71/93 General Fund contributions to the PERS are effectively made two fiscal years in arrears. Therefore, no transfer will be made in the current year. The necessary General Fund transfer for 1995-96, based on 1993-94 payroll, is expected to be roughly $450 million.

The State Teachers' Retirement System (STRS) receives contributions from teachers and their employers. These contributions, however, are insufficient to provide for the cost of teachers' basic retirement benefits or the protection of retirees' purchasing power. The shortfalls are covered by annual transfers from the General Fund. These transfers are proposed to increase by $60 million, from $758 million in the current year to $818 million in the budget year. The increase is due entirely to a change (required by statute) in the funding formula for the purchasing power protection program.

The budget also includes $329 million from the General Fund to pay the state share of health and dental insurance premiums for annuitants of various state-supported retirement systems. This is $12.5 million higher than estimated current-year expenditures and is due to an increase in the number of annuitants.

Employee Compensation. The budget includes $58.7 million ($43.9 million from the General Fund) to fund a salary and wage inflationary cost-of-living increase (COLA) for state employees on January 1, 1995. The amount in the budget assumes a 3.5 percent COLA. These funds would be allocated for COLAs only to departments whose employees directly serve public safety, provide 24-hour care, or are revenue-producing. All other departments would have to absorb the cost of the pay increase within existing resources. This policy decision accounts for most of the year-over-year reduction in employee compensation. In addition, for managers in civil service, the budget proposal substitutes a “pay-for-performance” salary review process for the COLA, under which managers would receive salary increases based on “certification of successful job performance.”

The budget also assumes $150 million of savings on a statewide basis ($75 million from the General Fund) as a result of the Governor's proposal to reduce manager and supervisor positions in state government by 10 percent. The number of positions and associated dollars to be reduced by individual departments has yet to be determined. The likelihood of the state attaining this level of savings is open to question, given the magnitude of the reductions, the late start in implementing the proposal, and the elaborate procedures that have to be followed under civil service laws and regulations to demote or lay off employees.

Tax Agencies. The Board of Equalization collects state and local sales and use taxes and various excise taxes and fees; oversees the administration of the property tax; assesses public utility property; and hears appeals of decisions by the Franchise Tax Board. The budget proposes expenditures of $176 million for the board in 1994-95 (exclusive of $86 million in reimbursements from local governments). This is an increase of about $6 million over current-year expenditures primarily due to additional employee compensation costs and costs to redesign the board's computer system.

The Franchise Tax Board is responsible for administering California's Personal Income Tax, Bank and Corporation Tax, Homeowners' and Renters' Assistance programs, and the Political Reform Act audit program. Funding for the board is proposed to increase by $8.6 million, from $258.2 million to $266.8 million. As with the Board of Equalization, the large majority of this increase is attributable to additional employee compensation costs.

General Services. The Department of General Services provides support services to state agencies. The budget proposes a *net* increase for the department of $3 million, from $123.3 million in the current year to $126.3 million in the budget year. When one-time expenditures in 1993-94 are excluded, the actual increase in spending for 1994-95 is approximately $19 million. Most of this increase is due to telecommunications expenditures (CALNET, 9-1-1, microwave equipment, and engineering services for clients) and the replacement of vehicles for the state's fleet.

MAJOR BUDGET CHANGES

Figure 3 portrays the changes in four major categories of expenditure (local government aid, retirement benefits, employee compensation, and state operations) which reflect the proposed $755 million decrease in expenditures for state administration in 1994-95. Also shown are selected changes in each of the categories.

The State's Retirement Programs. Retirement-related expenditures account for a significant part of state spending for the budget year. State expenditures in 1994-95 will total approximately $2 billion, including $1.7 billion from the General Fund, for various costs associated with public employee retirement. As summarized in Figure 4 (see page 12), the General Fund provides for employer contributions and/or various other payments to four public employee retirement systems: the Public Employees' Retirement System (PERS), the State Teachers' Retirement System (STRS), the Judges' Retirement System, and the Legislators' Retirement System. In addition, the state (1) makes social security and Medicare contributions for most state employees and (2) contributes to the payment of premiums for health and dental benefit plans for retired state employees.

General Fund payments to the PERS in 1994-95 would be $310 million higher than shown in Figure 4 except for an offset made possible by the last remaining funds in a special PERS account. None of these funds will remain to offset any portion of an expected $450 million General Fund payment that will be due in 1995-96. Altogether, we project that state costs for retirement and related programs will total approximately $2.6 billion in 1995-96, including $2 billion from the General Fund.

Figure 3

State Administration Proposed Major Changes for 1994-95 All State Funds

Retirement Benefits	**Requested:**	**$1.6 billion**	
	Increase:	**$222.0 million**	**(+16.6%)**

- $137.4 million for transfers to the Public Employees' Retirement Fund (Excludes $206 million transfer from nongovernmental cost funds)
- $60 million for transfers to the State Teachers' Retirement Fund
- $12.5 million for health and dental premiums for annuitants
- $12.2 million for contributions to Judges' Retirement Fund

Local Government Aid	**Requested:**	**$4.0 billion**	
	Decrease:	**$98.2 million**	**(—[a])**

- $130 million in shared revenues from elimination of a one-time apportionment to offset property tax transfers in 1993-94
- $30 million due to elimination of the renters' tax credit in 1992
- $25 million from elimination of one-time funds for enhanced property tax administration

State Operations	**Requested:**	**$0.7 billion**
	-No Net Change-	

- $6 million to replace vehicles in the state's fleet
- $2.7 million for CALNET installment payments
- $4.7 million for 9-1-1 reimbursements to local agencies

Employee Compensation Increases	**Requested:**	**$49 million**	
	Decrease:	**$111.9 million**	**(-69.5%)**

- $111.9 million due to smaller pay increase for state employees (3.5 percent versus 5 percent in current year) and Governor's proposal to require most departments to absorb pay increases with existing resources. (Annualization of current-year pay increase—estimated $308 million—built into individual department budgets.)

[a] Not a meaningful figure.

Figure 4

General Fund Costs for Retirement Programs[a] 1994-95 and 1995-96 (LAO Projections)

(In Millions)

Program	1994-95	1995-96
Public Employees' Retirement	$134	$450
State Teachers' Retirement	876	900
Judges' Retirement	50	55
Legislators' Retirement	1	1
Social Security and Medicare	285	290
Health and Dental Benefits for Annuitants	329	350
Totals	**$1,675**	**$2,046**

[a] Includes transfers to retirement trust funds for employer contributions, state mandates, retired judges' benefit payments, and other purposes. Does not include PERS and STRS administrative expenditures from trust funds. General Fund transfer to PERS in 1994-95 is net of $310 million offset from surplus accounts in the trust fund. Excludes costs for most University of California employees.

CROSSCUTTING ISSUES

OVERVIEW OF EMPLOYEE COMPENSATION ISSUES

A major portion of state government expenditures is for compensation of state employees. The Governor's Budget projects $7.8 billion of salary and wage expenditures for 183,500 authorized positions in 1994-95. These amounts do not include $3.5 billion for 85,000 state higher education positions. Accounting for employee benefits, and again excluding higher education employees, expenditures for state employee compensation will approach $10 billion in the budget year.

There are three major initiatives in the area of employee compensation in the Governor's Budget for 1994-95. These are:

- The budget assumes savings of $150 million ($75 million General Fund) in 1994-95 by reducing the number of managers and supervisors in state government by 10 percent.
- The budget assumes savings over the current and budget years totaling $28 million ($14.5 million General Fund) from institution of a "pay-for-performance" policy in lieu of previously authorized cost-of-living adjustment (COLA) increases.
- The budget proposes to allocate approximately $73 million in additional funds for the $133 million cost of the COLA increase scheduled for January 1, 1995. The balance of these costs would be absorbed by most state departments from their operating budgets.

We discuss the Governor's proposal regarding funding the general salary increase in detail in our analysis of the Augmentation for Employee Compensation (Item 9800). We discuss the reduction of manager and supervisor positions and the pay-for-performance policy below.

Ten Percent Reduction in Manager and Supervisor Positions

We recommend that the DPA and the Department of Finance provide to the fiscal committees the administration's department-by-department implementation plans for reducing manager/supervisor positions well in advance of May Revision letters.

As mentioned above, the budget assumes savings of $150 million ($75 million General Fund) in 1994-95 by reducing the number of managers and supervisors in state government by 10 percent. According to the Department of Personnel Administration (DPA), there are currently about 28,500 supervisors and managers overseeing the work of 140,000 full-time and part-time civil service workers. To accomplish this "downsizing" task, the DPA has imposed a freeze on appointments to management and supervisor positions in civil service, and has asked all state departments to submit plans to reduce manager/supervisor positions by 5, 10, and 15 percent. The plans are to be submitted to the DPA and the Department of Finance by March 1, 1994.

The $150 million savings estimate used in the budget is equivalent to approximately 10.5 months of the average salaries and benefits of existing manager/supervisor positions, applied to 10 percent of those positions. This is an optimistic savings projection. The sheer number of managers and supervisors involved in this proposal, combined with the elaborate nature of the civil service process, means that the 10 percent reduction may not be completed before September (as assumed by the budget totals). Moreover, many of those "demoted" to nonmanager/supervisory positions may be entitled under civil service laws to be paid at or very near their current salary levels, in which case assumed salary savings would be overstated. Finally, the initiative's success will depend to a great extent on receiving support, rather than resistance, from the departments and agencies that actually will be called upon to implement the reductions in their own organizations.

As a general concept, we believe reducing layers of management in California state government has merit. In actual implementation, however, legitimate concerns could arise regarding the pace and manner in which the reductions proceed, and consequent fiscal and program impacts. Given these potential concerns, we believe the Legislature should review the administration's department–by–department implementation plan. This information should be available for the Legislature's review well before the May Revision submittals, given the March 1 due date for departmental proposals to the DPA and the Department of Finance. Accordingly, we recommend that the DPA and the Department of Finance provide to the fiscal committees the implementation plans for reducing manager/supervisor positions well in advance of May Revision letters.

Pay-for-Performance Policy for Managers

We recommend that the DPA and the Department of Finance, prior to budget hearings, address concerns about the pay-for-performance policy for state managers. These concerns include (1) possible infringement on the Legislature's appropriation authority, (2) issues of basic fairness toward managers in state service, and (3) issues raised in a related lawsuit against the state.

On December 8, 1993, the Governor announced a new compensation policy for the approximately 4,000 managers in state government. On December 10, the DPA issued the following directives in order to implement the Governor's policy:

- A previously authorized COLA increase of 5 percent, due on January 1, 1994, was cancelled for all exempt and civil service *managers*. A second salary increase (of 3 to 5 percent depending on inflation), scheduled for January 1, 1995, also was cancelled.
- *Civil service* managers would be eligible to receive salary increases of *up to* 5 percent, at the discretion of their appointing power, provided that the appointing power certifies that the manager is performing successfully. (The budget further requires that departments fund any pay increases out of existing resources.)
- Department directors have the discretion *not* to authorize any pay increases for managerial employees during the current year.
- Exempt managers (appointed non-civil-service positions) will not receive any pay increase and most will continue until further notice on the "personal leave program," which reduces monthly pay by almost 5 percent in exchange for leave credits (similar to vacation credits) of one day per month.
- All salary increases for managers *after* January 1, 1994, will be subject to annual performance reviews, on the basis of which increases may be withdrawn or reduced.
- Performance pay decisions will be subject to appeal only on the basis of "political affiliation" issues or legally prohibited discrimination.

Finally, the DPA memorandum states that the department will develop a similar program for supervisors for implementation by January 1, 1995, and that it will pursue performance-based pay for rank and file employees in future collective bargaining.

As the DPA memorandum acknowledges, the pay-for-performance policy is a significant departure from the state's traditional approach to managerial pay. In our view, *the concept of reforming the state's process for granting merit pay increases has merit and deserves serious consideration*. We have the following concerns, however, with the specific actions taken by the administration.

The Actions Infringe on the Legislature's Appropriation Authority. The Legislature appropriated funds under Item 9800 of the 1993 Budget Act with the clear understanding that the purpose was for general salary increases for all state employees, including managers. Changing to a performance-based criteria for the increase for managers may be within the legal prerogatives of the DPA. In our view, however, the administration's budgetary actions infringe on the Legislature's appropriation authority in the following two respects:

- The 1993 Budget Act includes provisions stating that the funds appropriated for augmentation of employee compensation are to be allocated by the Department of Finance ". . . in such amounts as will make sufficient money available for each state officer or employee in the state service . . . to receive any such increases provided on or after July 1, 1993, by the Department of Personnel Administration . . .". The Governor, however, intends not to spend the funds appropriated for manager pay increases and instead to require departments to absorb pay-for-performance increases within existing resources.
- By requiring departments to absorb the costs of the current-year pay-for-performance program within existing resources, the budget redirects funds appropriated by the Legislature for a variety of programs to a new, and unrelated, pay program never authorized by the Legislature.

The Actions Confuse the Purposes of a General Salary Increase Related to Inflation and a Merit Increase. There are two basic types of pay increase—one intended to compensate for inflation and one intended to reward meritorious performance. The 5 percent salary increase negotiated by the DPA for represented employees and previously authorized for nonrepresented employees (including managers) was specifically for a COLA to compensate employees for inflation. In fact, the salary increase effective January 1, 1995 is set at 3 percent to 5 percent, dependent on a cost-of-living index. Since inflation equally affects all, across-the-board COLAS make sense. Whether or not a COLA should be granted to state employees under current fiscal circumstances is a valid issue. Objections to a COLA because of its across-the-board nature, however, misread its purpose.

The state's practice for giving "merit" salary increases is another matter. Under state law, there is a completely separate process for the granting of "merit" pay increases to state employees. In theory, this process recognizes meritorious work and provides for appropriate salary adjustments. In practice, however, the merit pay increase process has become virtually an across-the-board entitlement program. This has effectively defeated the purpose of a "merit" process. A true pay-for-performance policy *and practice* are needed. To accomplish a true reform in this area will require the involvement of the Legislature and the administration to recast the laws, regulations, and practices surrounding merit pay. The administration's action, unfortunately, confuses two types of pay increase that have entirely different purposes. It also provides no basis for assuming that there will be improvements in the current merit pay practice. For instance, if most agencies grant performance pay to virtually all eligible managers, there will have been no fundamental change. In fact, this is what has happened on the first round of the pay-for-performance programs. Based on information from the State Controller's Office, the vast majority of departments granted the maximum 5 percent increase to virtually all eligible managers.

The Action Raises Issues of Basic Fairness. Given that the purpose of the general salary increase was to adjust employees salaries for inflation, it is unfair to deny it to managers and grant it to everyone else. Another potential issue of fairness arises from the budget's requirement that departments absorb pay-for-performance raises granted to managers within existing resources. There are undeniably sharp differences among departments in their capacities to absorb additional costs. Inevitably, there will be cases of excellent managers in "poor" departments going unrewarded while mediocre managers in "rich" departments receive increases.

The Policy Does Not Adequately Reward Excellence. The action converts a 5 percent COLA increase for all managers into a 5 percent increase for (presumably) only the best managers, while leaving in place a 5 percent COLA increase for other employees. We think this sends the wrong message to those managers who are doing the best work for the state. A policy designed to reward and encourage excellence should at least provide salary increases greater than those given to other employees regardless of their performance. It also should guard against the possibility of supervised employees making more than their manager.

We recommend that the DPA and the Department of Finance address all of the above concerns prior to budget hearings.

We would also note that on January 14, 1994, Senator Alfred E. Alquist, the California State Managers and Supervisors Association, and the California Association of Highway Patrolmen filed suit against the DPA to overturn the pay-for-performance actions. The suit makes two basic claims:

- That the administration violated the constitutional separation of powers by diverting funds appropriated by the Legislature.
- That the imposition of the pay-for-performance program violates existing statutes regarding a manager bonus program, merit salary increases, and salary ranges.

The Superior Court in Sacramento has ordered the DPA to show cause why the pay-for-performance program should continue in lieu of a general salary increase for managers. At the time this *Analysis* was prepared the case was scheduled to be heard April 1, 1994.

TAX AGENCY CONSOLIDATION—INFORMATION SYSTEMS

The proposed integration of the state's tax information systems represents a real opportunity to improve state tax administration and generate long-run savings. The Legislature should direct the state's principal tax administration agencies to develop a plan for integrating information systems, and redirect funds to facilitate this planning effort. In addition, the Department of Finance should report to the Legislature on the consistency of recently approved data processing projects with this proposal.

A long-standing recommendation of the Legislative Analyst's Office has been to consolidate the state's existing tax administration functions into a new Department of Revenue. The Governor's Budget pledges that the administration will "continue to work cooperatively" towards this goal. As discussed in last year's *Analysis,* we believe that consolidation would increase accountability, generate considerable administrative efficiencies, and improve service to taxpayers.

The Governor's Budget also indicates that the primary tax administration agencies, the Board of Equalization (BOE), the Franchise Tax Board (FTB), and the Employment Development Department (EDD), will begin an effort to functionally integrate their tax information systems. While the budget provides no details regarding this initiative, staff from the three agencies have informed us that a task force has been established to begin discussing integration opportunities.

Benefits of Integration

In our view, integration of the information systems of BOE, FTB, and EDD is a necessary step towards the consolidation of tax administration, and would produce a number of benefits in and of itself. As a result, we support the administration's efforts in this area.

Savings to Taxpayers. One of the most significant benefits from integrating tax information systems is streamlining the relationship between the state and taxpayers. An integrated system can eliminate the need for taxpayers to report the same information to the state multiple times, since tax agencies would be better able to share information about the same taxpayer. For example, improved data sharing between FTB and the EDD can eliminate the need for individual taxpayers to file wage and salary income information when they file state income tax returns. In addition, an integrated system can increase the options for taxpayers to file information and make payments electronically, thereby reducing taxpayers' costs to process and pay taxes. For instance, a more fully integrated system can provide taxpayers with on-line access to their state tax records, where they could update tax information without the assistance of tax representatives or without filing a paper form.

An integrated system can also allow taxpayers to access information about each tax for which they have a liability from a single source, no matter which agency actually administers the tax.

Benefits to the State. Integrating state tax information systems can allow improvements in information sharing between tax agencies, and reduces the need to collect, process, and track the same information about taxpayers multiple times. An integrated system can also improve tax agencies' ability to respond to taxpayer inquiries regarding all their tax affairs, thereby reducing taxpayer confusion over which agency is responsible for a particular tax.

What Should the Legislature Do?

In the long-run, integrating tax information systems will require the Legislature to allocate funds to pay for costs to modify existing and develop new data processing systems. Because existing systems also will need to be redesigned and improved in the absence of integration, however, we do not believe the additional cost requirements imposed by integration would be substantial. Initially, however, there must be a substantial amount of planning for the integration effort by the three primary tax agencies and the Department of Finance.

Integration Master Plan. To facilitate this planning effort, the Legislature should direct BOE, FTB, EDD, and the Department of Finance to develop an Integration Master Plan in 1994-95 for integrating tax information systems. At a minimum, this plan should include the following:

- ***Integration Vision.*** Tax agencies must identify a common expectation of *what* integrated information systems should do for the state and for taxpayers.
- ***Strategic Plan.*** Tax agencies must develop a consensus of *how and when* current or proposed systems should be integrated.
- ***Planning Structure.*** Tax agencies, along with the Department of Finance, must establish an institutional structure and process in which the agencies can develop specific plans for integration. This planning structure would identify the roles and responsibilities of each agency, as well as provide a forum to resolve disagreements between agencies.

In addition, the Legislature should instruct BOE, FTB, and EDD to redirect up to $300,000 of existing planning funds to pay for consultant services to assist with developing the Master Plan. Finally, the Legislature should direct the Department of Finance to certify that each proposal by a tax agency (1) to modify an existing information system, or (2) to develop a new system, is consistent with the Master Plan, prior to approval of any Feasibility Study Report for such a project.

Current Efforts Should Be Consistent With Integration Objectives

The Governor's Budget proposes to continue two large-scale data processing system improvement projects that are currently underway at the BOE and the FTB. Although both of these projects were approved recently by the Department of Finance, no attempt was made to ensure that they are consistent with the initiative in the budget to integrate tax information systems.

Therefore, we recommend that the Legislature request the Department of Finance to report during budget hearings on whether these projects will impede or promote the initiative for tax system integration, and the steps that should be taken to improve their consistency with the integration objective.

PERFORMANCE BUDGETING OFFERS PROMISE, BUT OFF TO SLOW START

STATUS OF PERFORMANCE BUDGET PILOT UNCERTAIN

The Governor's Performance Budget Pilot Program has been slow to start and has delivered little in the way of visible evidence of performance budgeting.

In January 1993, the Governor proposed to change the state's budgeting process by pilot testing performance budgeting in four state departments. According to the Governor's Budget, the pilot program was being proposed because the state's traditional budget process had become "seriously dysfunctional." The administration indicated that performance budgeting, along with quality improvement pilot projects, offer the potential for substantial savings, improved performance, enhanced citizen satisfaction, and greater accountability in the delivery of state services. As proposed, the pilot program would involve the Legislature early on in the project, and the Legislature would be presented with budget "contracts" for the 1993-94 Budget. The Department of Finance was given the responsibility to manage the pilot project.

Pilot Departments Selected. The administration identified four departments as the initial pilot departments: Consumer Affairs, General Services, Parks and Recreation, and the Stephen P. Teale Data Center. The 1994-95 Budget proposes to add two more departments to the pilot—the Department of Toxic Substances Control and the California Conservation Corps.

Legislature Puts Program in Statute. The Legislature responded to the Governor's initiative by enacting Ch 641/93—the Performance and Results Act of 1993 (SB 500, Hill)—which in effect codified the administration's proposal with the exception that Chapter 641 requires budget contracts in 1994-95 (instead of 1993-94), and completion of the pilot program by January 1, 1996.

Elements of Performance Budgeting. In the administration's view, performance budgeting has seven essential elements, as listed in Figure 5.

Figure 5

Elements of Administration's Performance Budgeting Pilot Program

- ✔ Annual budgetary contracts between legislative budget writers and the administration
- ✔ Operational flexibility, which could include relief from statutory requirements
- ✔ Incentives for performance and efficiency, including the ability to reinvest 50 percent of any savings into discretionary activities
- ✔ An emphasis on long-term strategic planning.
- ✔ Development of performance measures
- ✔ Benchmarks for measuring operational efficiency
- ✔ A commitment to quality improvement

Status Review of Pilot Notes Early Slippage. In October 1993, as part of our Making Government Work Better series, we published *Performance Budgeting: Reshaping the State's Budget Process*, in which we assessed the Governor's pilot program. We noted that there was minimal detail as to how the program was to work, and that the program was significantly behind schedule. The most significant uncertainty at that time was how the administration intended to involve the Legislature in the program. We noted that the administration had failed to involve the Legislature "early on" as had been promised when the program was announced. We believed this to be a significant factor, because fundamental budget change is impossible without appropriate legislative involvement.

Little Evidence of Progress in Budget. Although the program has been slow to get off the ground, some indication of progress has been noted in some of the pilot departments (we discuss the extent of progress in the sections of this *Analysis* pertaining to the four pilot departments).

In terms of the proposed 1994-95 Budget, there is little evidence of a significant move toward performance budgeting. For example, the Budget Bill reflects some relatively minor changes which give the Department of General Services more control over its budget. Moreover, it is unclear whether *any* budget contracts will be offered to the Legislature for the 1994-95 fiscal year, or whether they will be offered in sufficient time for review by the Legislature's fiscal subcommittees, as required by Chapter 641. It is also unclear what role the administration anticipates the Legislature performing with respect to the performance budget pilot program, other than to consider budget contracts when they are submitted.

Implementation Costs Remain Unquantified

There will be significant, continuing costs to implement performance budgeting as proposed by the Governor, and the magnitude of that cost has not been identified to the Legislature.

The primary components of cost to implement performance budgeting will be the development and maintenance of strategic plans, the creation of information systems to collect, maintain and process data relating to performance measures, and the development and maintenance of quality improvement programs. Creating the information systems which are essential to performance budgeting will be costly on a statewide basis, as will the implementation of quality improvement programs.

Statewide implementation of performance budgeting could easily cost several millions of dollars in terms of state staff time and contracts with outside consultants for help in developing strategic plans and information systems, and establishing quality improvement programs. Some agencies will likely elect to accomplish these tasks on their own, while others may be forced to do so. Regardless of the method of implementation, the allocation of staff resources and expenditures for contracts will be both real and substantial. The administration has not provided the Legislature an estimate of the cost to implement performance budgeting, even for the pilot program.

What Should the Legislature Do About the Performance Budget Pilot?

We recommend that the Department of Finance provide the Legislature a better definition of the performance budget pilot program in order to enhance its chances for success.

Diminished Role for the Legislature? There has been an apparent shift in the administration's thinking with respect to the involvement of the Legislature in shaping performance budgeting. Whereas the 1993-94 Governor's Budget emphasized the need for legislative involvement beginning "immediately" in January 1993, there has been no such involvement. By way of contrast, the 1994-95 Governor's Budget is silent on the matter of legislative participation, other than the review of budget contracts. This situation, and the lack of any cost estimates for either the pilot program or statewide implementation, put the Legislature in the position of being expected to support a program without having been provided the fundamental information it should expect before approving a major new governmental program. Moreover, the administration proposes to add two more departments to the pilot program. While the purpose of a pilot is to confirm the merits of a concept prior to further expansion, the administration is proposing to expand this program before the pilot even gets off the ground.

Meeting the Legislature's Needs for Better Information. In order to correct this situation, and to help ensure that the pilot program has the best chance of success, we believe that the administration needs to provide the Legislature the following:

- A specific plan for completing the pilot program, including anticipated benefits and an implementation schedule showing major tasks and their estimated completion dates for each of the pilot departments.
- An estimate of costs for the pilot program for each of the pilot departments, by major category of expenditure (for example, developing strategic plans and information systems).
- The administration's plan for developing performance measures, including who will develop them, how they will be verified and reported, and whether the Legislature will have a role in the process.
- The administration's plan for applying sanctions in instances where budget contracts with the Legislature are not fulfilled by a pilot department.

Without the information described above, the Legislature will continue to be relegated to the role of observer as the administration implements performance budgeting. At this point, the Legislature has no reason to feel assured that budget contracts will address any of these matters. Nor does the Legislature know whether departments making a contract with the Legislature will be held accountable to uphold their part of the bargain.

We believe that the approach being pursued by the administration puts the pilot program at unnecessary risk, because the experience in other jurisdictions that have attempted performance budgeting has demonstrated the need to have legislative acceptance of performance measures, and confidence in reported results, in order for performance budgeting to succeed. For all these reasons, and to help ensure an effective pilot program evaluation, we recommend that the Department of Finance provide the Legislature with specific information about the administration's plans for performance budgeting. This information should be provided prior to the budget hearings, and should include:

- A detailed implementation plan.
- An estimate of costs and benefits for the pilot project.
- An explanation as to how performance measures will be developed, verified, and reported, and the Legislature's role in the process.
- The administration's policy on the use of sanctions for failure to uphold a budget contract.

Legislature May Need to Take the Lead. Another option for the Legislature is to consider working directly with individual departments. Some pilot departments are considerably ahead of others in terms of progress toward establishing some of the fundamental components of the administration's program, such as a strategic plan and the development of performance measures. If the Legislature believes that a particular pilot department is ready, the Legislature could work with the department during the budget hearings to define its own contract at that time.

Revenue Bond Financing Authorities and Special Advisory Bodies

Reorganization Proposal Contains Uncertainties

We withhold recommendation on $687,000 and 16 positions budgeted for the new California Revenue Bond Financing Authority (CRBFA) pending receipt of information from the administration, prior to budget hearings, concerning the elimination and consolidation of various entities.

The budget proposes to eliminate or consolidate several revenue bond financing authorities and special advisory bodies as part of the Governor's proposal to reorganize state departments. According to the administration, the purpose of these changes is to reduce cost and improve service. Specifically, the budget reflects the following:

- Elimination of *five* revenue bond authorities, programs, and commissions, on the basis that their functions are no longer needed.
- Elimination of *eight* revenue bond authorities, whose functions would be transferred to a new California Revenue Bond Financing Authority (CRBFA), which the budget proposes to establish (the budget proposes $687,000 and 16 positions for support of the CRBFA).
- Elimination of the California Debt Advisory Commission (CDAC), and consolidation of its functions into the State Treasurer's Office.

Streamlining State Government. Eliminating and consolidating state government functions to cut costs and improve service is not only a good idea, but one which should be considered seriously on a continuous basis. We support efforts to improve government through effective eliminations or consolidation, and we believe that the administration is on the right track in proposing to eliminate organizations that are no longer needed. Specifically, we support the administration's proposal to eliminate the following entities because the need for which they were established no longer exists:

- Local Agency Indebtedness Fund Loan Program.
- California Passenger Rail Financing Commission.

The Hazardous Substance Cleanup Financing Authority, also proposed for elimination, was actually eliminated pursuant to Ch 54/93 (SB 169, Boatwright).

In addition, we believe that the proposal to consolidate the CDAC into the State Treasurer's Office is reasonable because the consolidation would ensure accountability in a single entity (the Treasurer) while maintaining the CDAC's function.

Will Changes Really Improve Service at Less Cost? Although we agree there is no longer a need for the agencies listed above, we have two concerns regarding the remainder of the administration's proposal. First, according to the administration, the proposed changes will result in annual savings of approximately $2.3 million; however, the Department of Finance was unable to provide documentation to confirm the accuracy of the projected $2.3 million savings, or when these savings would actually occur. Second, the documentation provides no information as to how the proposed reorganization will improve the operation of the state's revenue bond financing which is one of the administration's primary goals. If the administration has erred and provided too few resources, work could take longer to perform and in doing so have both fiscal and policy implications.

Additional Information Needed. The administration's effort to streamline government to make it more effective is commendable; however, the Legislature should not be asked to adopt a reorganization proposal when it has not been provided sufficient information justifying it. As discussed above, the administration has not provided any information demonstrating that the proposed reorganization would produce a real net savings or improve service.

For all these reasons, we withhold recommendation on the $687,000 and 16 positions proposed for the new California Revenue Bond Financing Authority, pending receipt of information prior to budget hearings which would enable the proposed reorganizations to be evaluated as to the likelihood of their resulting in reduced cost and improved service

STATE ADMINISTRATION

DEPARTMENTAL ISSUES

AUGMENTATION FOR EMPLOYEE COMPENSATION (9800)

The budget does not provide the amounts needed to fully fund employee pay increases in 1994-95. In addition, our review identifies other problems with the administration's approach to employee pay increases in the current year and budget year.

Background. Under approved memoranda of understanding (MOU's) for the three years 1992-93 through 1994-95, represented state employees:

- Received a 5 percent pay increase on January 1, 1994.
- Are scheduled to receive a 3 to 5 percent increase (depending on inflation) on January 1, 1995.

In July 1992 the Department of Personnel Administration (DPA) approved identical increases for nonrepresented employees.

The purpose of Item 9800 is to provide the funds needed for the pay increase that becomes effective January 1, 1995. When the pay increase takes effect, the Department of Finance allocates funds from this item to the various departments. (The full-year effect of the January 1994 increase is already built into each department's budget for 1994-95 rather than included in this item.)

We have identified three major issues with the budget's approach to funding the pay raises in 1994-95. We discuss these issues below.

The Budget Overstates the Likely Rate of Pay Increase

According to the Governor's Budget, the MOU's authorize a January 1995 pay increase (cost-of-living adjustment (COLA)) of between *3.5 percent* and 5 percent, depending on inflation. The budgeted amounts are based on an assumption that the pay increase will be at the minimum—3.5 percent. However, the MOU's actually authorize a minimum increase of *3 percent*. Considering the inflation index that the MOU's specify for the purpose of calculating the increase, and the time period over which inflation is to be measured (first quarter 1993 to first quarter 1994), it is almost certain that the 3 percent minimum increase will govern.

As a result, the budget overstates the likely cost of the January 1995 increase. The budget assumes that the 1994-95 cost of the pay (and related benefits) increase for all state employees will be approximately $158 million. Using instead the 3 percent inflation factor, the 1994-95 costs will be approximately $133 million. (In our estimate we also assume a lower factor for those benefit costs that are tied to salary/wage increase than assumed by the administration.)

The Budget Forces Most, But Not All, Departments to Absorb the Pay Increase

Although projecting total costs for the 1995 pay increase of $158 million on the basis of a 3.5 percent raise, the budget includes only $72.7 million ($50.9 million General Fund) to fund the increase under Item 9800.

Departments do not have discretion to deny the pay increase to represented employees, except for managerial staff (another issue discussed below). Therefore, the fact that the budget does not fully fund the costs of the raises means that most departments must absorb the unfunded portion within existing resources. Under the administration's approach not all departments and programs are to be treated alike. The budget states that Item 9800 funds will be allocated only for pay increases for employees who "...provide direct public safety, 24-hour care services or are major revenue producers."

According to Department of Finance staff, funds will be allocated to only 14 departments, to the extent that they have employees meeting this definition. Figure 6 lists these departments and the estimated amounts that would be allocated.

Approximately $21.3 million of the total amount not provided for the January 1995 pay increase is related to pay increases for managers, a special case under the administration's proposal that we discuss below.

Figure 6

Augmentation for Employee Compensation Programs To Receive Funds for January 1995 Increase

(Dollars in Thousands)

Department/Program	General Fund	Other Funds	Total
Public Safety:			
Corrections	$35,614	$538	$36,152
Forestry and Fire Protection	3,135	1,229	4,364
Youth Authority	1,550	3	1,553
Highway Patrol	—	7,039	7,039
State Police	—	314	314
Alcoholic Beverage Control	—	152	152
24-Hour Care:			
Developmental Services	3,879	3,461	7,340
Mental Health	1,637	2,419	4,056
Veterans' Home	350	221	571
Special Schools	643	44	687
Revenue Producers:			
Board of Equalization	1,477	864	2,341
Franchise Tax Board	2,258	107	2,365
Employment Development	196	5,448	5,644
Conservation	112	—	112
Totals	**$50,851**	**$21,839**	**$72,690**

The Budget Deletes Funds for Pay Increases for Managers

On December 8, 1993, the Governor announced a new compensation policy for the approximately 4,000 managers in state government. On December 10, the DPA issued directives to implement the policy. Among the actions taken, the DPA cancelled the previously authorized COLA for managers scheduled for January 1994 and January 1995. In place of the COLA, *civil service* managers are eligible to receive salary increases of up to 5 percent, provided their department certifies that the manager is performing successfully. (Managers exempt from civil service will not be eligible for either a COLA or a pay-for-performance increase.)

If departments grant pay-for-performance increases to managers, they must do so within existing resources. Accordingly, the budget indicates that the administration will not spend the $7 million ($3.5 million General Fund) appropriated under Item 9800 of the 1993 Budget Act and earmarked for managerial pay increases. As discussed in our overview of employee compensation issues in the Crosscutting Issues section of this chapter, we believe the reversion of funds, combined with the granting of pay increases from existing departmental appropriations, is inconsistent with the provisions of Item 9800 of the 1993 Budget Act.

In 1994-95, the budget assumes savings of $21.3 million ($11 million General Fund) from cancellation of the COLA for managers and the requirement that most departments absorb pay-for-performance increases within existing resources.

Options for the Legislature Regarding Employee Pay Increases

The Legislature has four basic options in approaching employee COLA pay increases in 1994-95: (1) approve as budgeted, (2) fully fund the pay increases, (3) require all departments to absorb the pay increases, and (4) cancel or reduce the size of the pay increase. Given the state's current fiscal situation, and the consequent pressures on the provision of program services to the public, we believe the last of these options is the most appropriate.

The Legislature has four basic options in approaching COLA pay increases in 1994-95. We discuss each option below.

Approve as Budgeted. We believe the approach taken in the budget is flawed in several respects, as follows:

- ***Fairness***. Denying a COLA to managers and granting it to all other state employees raises an issue of basic fairness. Also, it is inevitable under the budget approach that excellent managers in "poor" departments will not receive pay-for-performance increases while mediocre managers in "rich" departments will.
- ***Hidden Program Impacts***. All but 14 departments must absorb the COLA for nonmanagerial employees within existing resources. In addition, all departments must absorb pay increases that may be granted to managers. We estimate that the amount that would have to be absorbed across state government would range from $52 million to $56 million, depending on the extent to which manager pay raises are granted. Given all the other costs that departments have had to absorb in recent years, this additional

requirement is bound to have impacts on the delivery of program services to the public.

If the Legislature wishes to proceed with the funding approach proposed in the budget, we would recommend that the Legislature reduce Item 9800 by a total of $9.6 million ($7 million General Fund) to account for the likely 3 percent pay increase (rather than the 3.5 percent rate assumed in the budget) and a lower factor for benefits.

Fully Fund Employee Pay Increases. This approach would require augmenting the budget. In the present fiscal context, this would mean making reductions elsewhere. We estimate that an additional $73 million ($24 million General Fund) would be needed to fully fund employee pay increases, including $16.8 million ($8.6 million General Fund) for restoration of COLA increases for managers.

Require All Departments to Absorb Pay Increases. This approach would reduce net expenditures compared to the budget by $58.7 million ($43.9 million General Fund), and would create unknown program impacts. On the other hand, the administration has provided no evidence that the 14 departments that would receive additional funding in the budget for employee compensation are less able than other state departments to find economies in their operations.

Not Grant the Pay Increase Scheduled for January 1995. This approach would (1) save the state $58.7 million ($43.9 million General Fund) and (2) eliminate the need for up to an additional $56 million of hidden program reductions statewide (by relieving departments of the obligation of funding pay increases with existing resources).

Each of the seven bills enacted to ratify the 21 negotiated memoranda of understanding (MOU) with represented employees includes a section specifying that any MOU provision which is scheduled to take effect on or after July 1, 1993, and which requires the expenditure of funds, shall not take effect unless funds for these provisions are specifically appropriated by the Legislature. Each measure further states that in the event funds for any of these provisions are not appropriated, the state and the affected employee organizations shall renegotiate the affected provisions.

As a result, the pay increase scheduled for January 1995 is conditioned on the Legislature appropriating the funds requested under Item 9800. Thus, the Legislature has the option of saving $58.7 million ($43.9 million General Fund) by not approving the pay increase. Alternatively, the Legislature could save lesser amounts by providing for a smaller pay increase.

Given the state's current fiscal situation, and the consequent pressures on the provision of program services to the public, we believe the option of not granting the COLA is the most appropriate of the options available to the Legislature.

CONTRIBUTIONS TO THE JUDGES' RETIREMENT FUND (0390)

The Judges' Retirement Fund provides benefits for those justice, municipal, superior, appellate, and supreme court judges, and their survivors, who are members of the Judges' Retirement System (JRS). This system is administered by the Public Employees' Retirement System (PERS).

The primary revenues deposited in the fund come from the following sources:

- ***Active members' contributions***, equal to 8 percent of members' salaries ($12.5 million in 1994-95).
- ***Fees on civil suits*** filed in municipal and superior courts (about $4.5 million).
- ***General Fund appropriations*** ($50.4 million in 1994-95), equivalent to 8 percent of the salaries of authorized judicial positions ($12.6 million) *plus any amount necessary to cover JRS benefit payments each year* (an additional $37.8 million in the budget year under Item 0390).

Members of the JRS earn retirement benefits equal to a percentage (up to 75 percent) of the *current* salary of the judicial office last held. The JRS will pay an estimated $68 million in benefits to 1,225 annuitants in the budget year. This amount is about $3 million (5 percent) more than estimated payments in the current year.

Funding Problems of the JRS

The contributions made by current members of the JRS and the statutory contributions by the state go directly to pay benefits to current retirees, providing nothing for the eventual retirement of current judges. Moreover, these contributions are not adequate even to cover the benefit payments to current retirees, forcing the General Fund to make up the difference in Item 0390 of the annual Budget Act. In order to honor 1994-95 benefit payments to current retirees, the budget includes a subsidy of $37.8 million from the General Fund—$11.5 million above the current-year subsidy. Due to the chronic failure of the state to provide funds for the future retirement needs of current judges, the unfunded liability of the JRS has grown to *$1.3 billion*, based on the most recent actuarial valuation of the system (1992).

ADDRESSING THE JRS' PROBLEMS

We recommend that the Legislature enact legislation to establish a new retirement program for judges taking office in the future, in order to reduce long-run state costs for judges' retirement. The legislation should incorporate the retirement plan developed by the Select Committee on Judicial Retirement, with modifications to further reduce state costs. We further recommend reductions to Item 0390 of the Budget Bill totaling $6.5 million.

Recent Legislative Activity

In 1992 the Legislature enacted two bills that would have made fundamental changes to judges' retirement, but the bills were vetoed by the Governor. Assembly Bill 1031 (Bentley) would have increased member contributions from 8 percent of salary to 11 percent. Senate Bill 1563 (McCorquodale) would have created a new, less costly, retirement plan for judges appointed or elected after the effective date of the bill. The Governor indicated in his veto messages that, although reform of judges' retirement is necessary, neither bill received the full review through policy and fiscal committees warranted by the issues involved. The Governor also expressed concern about maintaining the state's ability to attract superior talent into the judiciary. He invited the respective authors to re-introduce legislation in the 1993-94 session.

In 1993, Senator McCorquodale introduced SB 65 to reform the JRS. At the time this analysis was prepared, SB 65 had been referred to a conference committee.

Select Committee on Judicial Retirement

After the Governor vetoed AB 1031 and SB 1563, the Chief Justice appointed a select committee to develop recommendations to the Governor and Legislature regarding changes in judges' retirement. The committee's report was released in May 1993. This report provides an important starting point for legislative efforts this year to reform the JRS.

Proposed "Judicial Retirement Program" for New Judges. The centerpiece of the select committee's report is a recommended new retirement plan for judges taking office after the effective date of necessary implementing legislation. This new plan has several features that, taken together, should result in reduced state costs for judges' retirement *in the long run*. Figure 7 compares the key features of the select committee's recommended plan with the existing JRS.

As shown in Figure 7, the recommended judicial retirement program would be less costly than the JRS. The lower projected cost of the new program is due mainly to two features—a higher minimum retirement age (63 instead of 60) and a less generous cost-of-living adjustment (a 3 percent annual cap instead of adjustments tied to increases in active judges' salaries).

The cost shown for the new judicial retirement program was estimated by a consulting actuary retained by the select committee. The estimate for the JRS was prepared by another actuary retained by the PERS, which administers the JRS. Two points should be noted. First, since the two actuaries used, in some cases, different assumptions, the estimates are not strictly comparable. Second, the estimates are just that—*estimates*, and are subject to change in the future.

ANALYSIS AND RECOMMENDATIONS

State Faces Risk of Higher Contributions in Future

The inherent variability of actuarial valuations poses an important issue for the Legislature's consideration—how to apportion the risk of periodic changes in contributions that result from successive actuarial valuations. The select committee's proposal would place all of that risk on the state, because it would hold the judges' contribution rate at 8 percent regardless of changes in program cost. We believe a sounder and more appropriate policy would apportion changes in contribution rates equally between the state and the judges who will benefit from the program. We therefore recommend that legislation establishing a new judicial retirement program provide for state and judges' contributions to move together (either upward or downward) in response to actuarial valuations, based on a fixed ratio between the *initial* contribution rates that the Legislature decides to set for each.

New Program Still Expensive Compared to Other Plans

The proposed judicial retirement program, while less expensive than the JRS, would still be more expensive (in terms of percent of affected salaries) than any state retirement plan in place for other public employees. Figure 8 compares cost and other features of the new judicial

BOARD OF EQUALIZATION (0860)

The Board of Equalization (BOE) is one of the state's two major tax collection agencies. It collects state and local sales and use taxes and a wide variety of business and excise taxes and fees, including those levied on gasoline, diesel fuel, cigarettes, and hazardous wastes. The BOE also oversees the administration of the property tax by county assessors and assesses property owned by public utilities that spans more than one county. Finally, the BOE is the final administrative appellate body for personal income and bank and corporate taxes, as well as for the taxes it administers.

The proposed budget for the BOE maintains baseline expenditures and provides increased funding for its central data processing system. As proposed, the board's total funding would increase by approximately $15 million, or 6 percent, over current-year expenditures. Over half of this increase is attributable to increases in employee compensation. In addition, the budget reflects a $3 million increase for costs of refunding invalidated sales taxes in San Diego County.

Outside Help Needed to Manage Computer Migration Effort

We recommend that the Legislature direct the Board of Equalization to hire a consultant to oversee the migration and design of its new data processing systems.

The budget requests an augmentation of $3.2 million in the budget year to continue the board's effort to redesign and relocate its central data processing systems. An additional $4.2 million will be required over the following two years to complete this effort.

Project History. In 1991-92, the board began an effort to simultaneously redesign and relocate its data processing systems from a mainframe computer funded and operated by the board to the Teale Data Center (TDC). The primary justifications for this effort were that the board would (1) administer its tax programs more effectively, (2) absorb increases in workload more efficiently, and (3) eliminate the costs associated with managing its own mainframe computer. The Legislature augmented the board's budget by approximately seven personnel-years and about $1 million for 1991-92 to begin a $30 million, five-year effort to migrate its processing systems to TDC. The initial effort consisted largely of planning efforts; however, during 1991-92 the board also completed a migration of its taxpayer registration system to TDC.

In 1992-93, the board's budget was augmented by almost $2.5 million, consistent with the five-year plan, to begin the process of redesigning and migrating its other systems to TDC. An analysis by board staff in November of 1992, however, indicated that costs to operate the board's systems at TDC would be significantly *above* initial projections. In addition, staff found that redesigning and migrating its systems simultaneously was not possible, and that at least one additional year was needed to complete the project as planned. As a result of these findings, the board began to reassess the project, including the question of whether other public or private sector vendors could provide less expensive computing services.

In September of 1993, the board issued a revised plan to redesign and relocate its data processing systems. The revised plan was approved by the Department of Finance in December of 1993. While this plan continues to call for the board to migrate its systems to TDC, it requires the board to hire up to 20 data processing consultants for up to three years, beginning in 1994-95. In addition, the board would redesign only a portion, rather than all, of its data processing systems. The net effect of this revision is to increase total project costs by $7.4 million (to $37.3 million), delay the completion of the project for an unspecified period of time, and leave the board with incompatible processing systems in the interim.

Successful Completion of Project Uncertain. While the BOE's revised plan appears to be more realistic than its first plan, there are at least three issues which may lead to further delays or cost overruns.

First, as a condition for approving the board's revised plan, the Department of Finance required the board to structure contracts for consultants so that payments would be linked to the completion of specific usable projects within certain time frames. We support Finance's effort to require the use of consultant contracts which focus on deliverable “outputs” rather than project inputs, such as hours of consultant time. Department staff indicate, however, that the board will be among the first state agencies to structure a contract for computer services in this manner. Consequently, the board may face additional risks in completing its plan as a result of the state's lack of experience in using this process to obtain system development services.

Second, other factors not related to the migration/redesign effort may prevent the board from dedicating the amount of vendor and staff resources necessary to complete the project. The BOE staff indicate that a primary reason for past project delays is that staff were diverted to address other data processing tasks associated with changes in tax laws, especially the 1991 sales tax rate increases. If there were additional changes in the sales tax—for instance, as a response to the Los Angeles earthquake—there would be an additional diversion of resources from the migration effort.

Finally, current estimates of operating costs at TDC do not fully account for likely changes at the TDC and the effect of system design issues which have yet to be resolved. Specifically, the TDC will revise the method it uses to track costs in 1994-95 potentially leading to further changes in its pricing policies. Because of these changes by TDC, and uncertainties over the design of the board's new processing systems, actual costs are likely to be substantially different from current estimates.

The Board Should Acquire Management Assistance. The board's experience of delays and cost overruns is not unlike the experience of other state agencies in their effort to implement major, computer-based projects. Specifically, the Franchise Tax Board experienced a delay of about three years and $40 million in cost overruns as it implemented its new Taxpayer Information System (TI) for the personal income tax. Because of the difficulties in implementing large systems, the performance of the BOE to date, and the significant uncertainties associated with this project, we recommend that the Legislature direct the board to contract for management of this project with a private vendor experienced in the successful management of large-scale computer-based projects. This vendor would report to the board's senior managers and would be responsible for managing consultant and staff resources engaged in redesigning and relocating the board's systems. This vendor should also help evaluate the effect of the pending TDC pricing policy changes on the project.

In our view, the tremendous uncertainties associated with this project are likely to result in actual costs differing, potentially significantly, from the augmentation already requested in the budget. Consequently, we see no need to augment the request specifically for this purpose. Therefore, we recommend that the board pay for management consultant services with resources in this proposal. Potential funding shortfalls as a result of consultant costs can be addressed along with the other augmentations that are likely to be requested in future years.

Merit Salary Adjustment Augmentation Lacks Performance-Based Justification

We recommend deletion of $3,369,000 requested to offset costs associated with merit salary adjustments, because the board is unable to provide any reasonable basis for its contention that audit recoveries will be adversely affected if these funds are not provided.

In preparing the *1994-95 Governor's Budget*, the Department of Finance instructed all state agencies not to include funding for the costs of merit salary adjustments (MSAs) within their baseline funding levels. While all other state agencies are expected to absorb these costs, the budget provides an exception for the board. This exception is premised on the argument that the board would have no choice but to fund these costs by reducing the number of positions allocated to its tax audit function by 76 positions. Based on its' long-standing assumption that additional tax auditors produce approximately $5.50 per dollar of cost in additional audit *assessments*, the board contends that the failure to fund the cost of MSAs in 1994-95 will reduce state *revenue* collections by about $19 million (all funds). We have several concerns about the board's contentions.

Assumptions Not a Substitute for Performance Measurement. As noted above, the board has for many years asserted that additional auditors produce new assessments at a $5.5-to-$1 ratio. As we pointed out in last year's *Analysis*, this assumption is based on old audit survey results conducted prior to recent, significant expansions of funding for the BOE's audit staff. These expansions have increased the board's audit staff by approximately 25 percent beginning in 1991-92.

These expansions of the board's audit staff are important to consider because of the declining marginal productivity of additional auditors. Consistent with legislative direction, the board allocates its audit resources to audits on the basis of the audit's expected productivity: the most productive audit cases are assigned first, and then the next most productive, and so on until the available audit resources are fully assigned. Statistical work performed by the board in prior years confirms that this is actually how it works out in practice—there is a declining trend in productivity that corresponds to the priority that the audit was assigned.

Prior to the expansion of audit staff in 1992, the board argued that its least productive audits had a recovery rate of approximately $5.5-to-$1, based on audits conducted in the 1989-90 fiscal year. The board now argues that its recovery rate is $5.6-to-$1, based on a survey of the productivity of beginning auditors during the July-September 1993 period. The board argues that this survey is an adequate proxy for actual marginal productivity data because beginning auditors are typically assigned to the lowest priority audit cases. However, similar data for the 1992-93 fiscal year appear to show a steep decline in productivity (as much as one-third less) for beginning class auditors.

We find these data to be inconclusive for purposes of evaluating the productivity of the audits that would be abandoned if this request is denied. Specifically, these data describe the average assessment-generating performance of a large pool (approximately 20 percent as of September 1993) of the board's auditors, and do not reflect any consideration of the audit selection process. That is, even assuming that these are an accurate *average* measurement for the entire class of beginning auditors, the board has made no effort to evaluate their *marginal* productivity—the results of the last audits assigned. We believe it is extremely unlikely that the board's audit recovery rate has actually remained stable in the face of a 25 percent expansion of its audit staff, and that better information is needed to ascertain the actual current marginal recovery rate.

Assessment Measure Overstates Potential Revenue Collections. We also have become concerned that the use of the net assessment measure of audit productivity is overstating the potential level of revenue gains from changes in the level of the audit function. While tax assessments represent valid *estimates* of the amount of self-assessed tax that has been under-reported by taxpayers, the amount of taxes actually paid as a result of these assessments is typically less. This is because a portion of the assessment is often cancelled through the appeals process and because in many cases the tax becomes uncollectible due to the passage of time before collection activities begin. The Franchise Tax Board has in recent years modified its performance monitoring systems to recognize this interaction, and has found it necessary in some cases to discount the level of audit assessment by as much as 50 percent to reflect potential collection problems. The board is unable to provide any information as to how their collections experience affects the amount of *assessments* that are actually translated into *revenue* collections.

Based on these concerns, we recommend that the proposed augmentation be denied because the board's justification is essentially an input-based argument—that is, more funds are needed to maintain existing position levels—rather than an argument based on actual performance in the audit function. We further recommend that the board report at budget hearings the results of its efforts to comprehensively review the marginal productivity of the audit function, including the influence of collection efforts on actual revenue collections resulting from audit assessments.

Court Puts Legislature's Refund Plan on Hold

We recommend the adoption of Budget Bill language making the $3,111,000 requested for administrative costs of issuing refunds in the Rider case contingent on court action allowing the Legislature's plan for these refunds to proceed. In addition, we recommend that the Legislature direct the board to report on the direct and indirect costs it incurs to administer these refunds.

The budget proposes to augment the board's budget in 1994-95 by $3.1 million in reimbursements to administer sales tax refunds required by a California Supreme Court decision in the case of *Rider v. County of San Diego*.

In December of 1991, the California Supreme Court ruled that a one-half cent sales tax imposed with majority voter approval by the San Diego County Regional Justice Facility Financing Authority conflicted with provisions of Proposition 13, and therefore was an unconstitutional tax. Chapter 1060, Statutes of 1993, (SB 263, Mello and Killea) authorizes the board to refund tax payments made to the Authority. This act requires the board to make direct refund payments to some taxpayers, and lower the sales tax rate in San Diego County, offsetting revenue losses with revenues collected for the Authority. Pursuant to this legislation, the board intends to lower the rate in San Diego County on April 1, 1994. The act also appropriated $2.1 million to the board in 1993-94 to begin administering the refund process.

Court Challenge to Board Administration of Refunds. In August 1993, a superior court judge ruled in favor of a challenge to the state's legal authority to administer the refund process. The board appealed this ruling and is now waiting for a decision on its appeal. If the appeals court rules in favor of the board, the board will implement its refund administration plan. If, however, the board loses its appeal, Chapter 1060 would probably become invalid and the board could not implement the tax rate reduction or issue any additional refunds. It is not clear exactly how the refunds would be made if Chapter 1060 is invalidated, but certainly the Legislature may wish to exercise some oversight over any refund process implemented by action of the court. As a result, we believe that only the $3.1 million augmentation in the board's budget should be available for this purpose, and it should be available only if a final judicial decision is issued in favor of the board. The appeals court is expected to rule on this issue sometime in March or April of 1994, but further appeals may delay the resolution of this issue into the budget year. On this basis, we recommend the adoption of the following Budget Bill language in Item 0860-001-001:

> Of the total amount appropriated by this item, only the amount of $3,111,000 is available for expenditure for the purpose of making refunds of local sales taxes collected for the San Diego County Regional Justice Facility Authority, and these funds are available for expenditure only pursuant to the provisions of Chapter 1060, Statutes of 1993.

Refunds Pose Threat to Board's Tax Administration Duties. Pursuant to Chapter 1060, board staff have organized and implemented a program to administer the refund payments and the tax rate reduction in San Diego County. Staff indicate, however, that the refund program may have an adverse influence on the board's ability to carry out its other responsibilities.

Specifically, there is some risk that the temporary rate reduction in San Diego County will increase the overall number of taxpayer payment errors. A higher error rate, in turn, would increase return processing workloads, as well as increase the workload on the board's existing central data processing systems. Unexpected workload increases for the data processing system could potentially divert data processing staff from the effort to redesign and relocate these systems at the Teale Data Center (see earlier issue).

As a result of these uncertainties, we recommend that the Legislature ask the board to report by December 1, 1994 as to its progress in administering these refunds. This report should include an analysis of both the direct and indirect costs of administering these refunds, and any unforeseen effects this effort has had on the administration of other sales and excise taxes.

Electronic Funds Transfer Savings Misplaced

The board cannot identify tax processing savings due to the expansion of the electronic funds transfer payment system. As a result, we withhold recommendation on the proposed increase to manage electronic funds transfers.

The budget proposes to augment the board's budget by $501,000 to reflect increased costs associated with the Electronic Funds Transfer (EFT) payment program. In 1991, legislation was enacted (Ch 473/91, SB 467—Deddeh) which required certain taxpayers to make tax payments by means of EFT. Beginning in 1993, taxpayers which made monthly sales tax payments in excess of $50,000 were required to make tax payments using EFT. Beginning in January 1995, taxpayers who make monthly sales tax payments in excess of $20,000 will be required to use EFT as well.

Board Reports Increases in Taxpayer Errors and Processing. Board staff report that the board is experiencing a higher-than-anticipated rate of inquiries and errors from taxpayers participating in the EFT program. Staff indicate that such problems are not inconsistent with implementing new tax programs, and should decrease as more taxpayers are required to use this program. Over time, the board expects taxpayer errors and inquiries to return to more normal levels, or possibly decline, as taxpayers become familiar with the program.

Fewer Forms Should Mean Some Savings. Taxpayers participating in the EFT program file fewer paper forms with the board, since much of the information the board needs to process tax payments is transferred electronically. In fact, our analysis using preliminary data indicates that the board may process up to 2 percent fewer documents per year as a result of taxpayers using the EFT program.

The board, however, does not identify these savings in its request for additional funding. As a result, we withhold recommendation on the request to administer the EFT program until the board can identify the savings associated with this program.

Cigarette Tax Compliance Plan Lacks Direction

The board has not considered alternative strategies to address cigarette and tobacco tax evasion. As a result, we recommend that the Legislature deny the request to augment the board's cigarette tax compliance staff. (Reduce Item 0860-001-230 by $363,000.)

The budget requests an augmentation of $363,000 from the Cigarette and Tobacco Products Surtax Fund for additional staff to investigate reports of cigarette and tobacco tax evasion. Currently, there is a state excise tax on cigarette and tobacco products at the rate of 37 cents per pack of 20 cigarettes. In 1989, this tax was increased by 25 cents per pack (from 10 cents) by Proposition 99. It was increased by an additional 2 cents per pack on January 1, 1994 by Chapters 660 and 661, Statutes of 1993, to fund breast cancer research. Revenues from the 25 cent tax increase are allocated to various health and resource programs, while revenues from the original 10 cent rate are allocated to the General Fund.

Plan Falls Short. Staff from the board indicate that cigarette tax evasion is increasing. For example, they cite an increase in the number of complaints from taxpayers about cigarette tax evasion. In addition, they cite information from the federal government regarding increases in the confiscation of illegally imported cigarettes.

This type of anecdotal information may provide an indication of a growing problem, and certainly high rates of taxation on cigarettes do provide an incentive for tax evasion. The board plans to use resources funded by this request to investigate "tips and leads" about cigarette tax evasion. However, the board has not considered alternative, potentially more cost-effective, strategies to prevent cigarette tax evasion or better cooperate with federal and local law enforcement agencies. For example, state laws which allowed local law enforcement agencies to more easily retain a large portion of assets seized during enforcement actions sunsetted on December 31, 1993. As a result, local officials may be willing to divert more resources to cigarette tax evasion cases since, under current law, county district attorney's may retain 50 percent of criminal penalties levied against the tax evaders.

In addition, the revenue increases associated with this proposal appear to be suspect. Specifically, these increases are based on a limited experience of tax evasion cases and are dependent on redirecting current audit staff from other productive activities. The losses from foregone audit activities are not described in this proposal.

As a result, we recommend that the request for additional staff to investigate cigarette tax evasion be denied.

FRANCHISE TAX BOARD (1730)

The Franchise Tax Board (FTB) is one of the state's two major tax collection agencies. The FTB's primary responsibility is to administer California's Personal Income Tax (PIT) and Bank and Corporation Tax (B&C). The FTB also administers the Homeowners' and Renters' Assistance programs and the Political Reform Act audit program. The FTB consists of the Director of Finance, the Chair of the State Board of Equalization, and the State Controller. An executive officer is charged with administering the FTB's day-to-day operations, subject to supervision and direction from the board.

The budget proposed for the Franchise Tax Board is approximately $10 million, or 3.8 percent, above estimated current-year expenditures of $262 million. Over 80 percent of the increase is attributable to increases in the costs of employee compensation. The largest single increase is a permanent $7.5 million augmentation from the Motor Vehicle License Fee Account and the Motor Vehicle Account to collect delinquent vehicle registration fees.

FTB's Temporary Augmentation Becomes Permanent

The proposed budget does not reflect the completion of temporary audit activities. In order to correct for this oversight, we recommend a reduction of $900,000. (Reduce Item 1730-001-001 by $900,000.)

The Legislature augmented the FTB's budget in the current year by approximately $14 million to increase the FTB's audit and collection activities. The FTB estimated that this augmentation would generate approximately $86 million in General Fund revenues.

One activity funded by this augmentation was a *temporary* increase in staffing to review business protests of audit assessments issued by the board. Taxpayers who protest audit results are not required to pay the assessments until a final judgment on the assessment is issued. Staff at the FTB argued that a temporary increase in the audit protest review staff, at a cost of $900,000, would allow the FTB to resolve a backlog of audit protests that had developed over the past few years. Resolving the backlog of protests would result in a one-time acceleration of revenue ($36 million) into 1993-94.

"Temporary" Increase Still in Budget. Preliminary information from the FTB indicates that this augmentation has reduced the number of backlogged cases, and has resulted in an acceleration of revenue into 1993-94 ($10 million). The proposed budget, however, does not reflect the Legislature's intent that this activity be carried out on a one-time basis in 1993-94 only. In order to correct for this oversight, we recommend that the FTB's budget be reduced by $900,000.

Workload Augmentation Requires Further Review

We withhold recommendation on $736,000 requested to provide for expected workload growth, pending receipt and review of revised data on tax return volume.

The budget proposes to provide a $736,000 increase to accommodate the expected workload growth for various return processing and taxpayer assistance activities. Projections for workload growth are based, in large part, on the estimated volume of tax returns to be received and processed during the budget year. Tax return volume estimates are based primarily on forecasts of various economic and demographic variables provided this past fall by the Department of Finance that are believed to affect the total volume of returns filed by California taxpayers.

The Department's latest forecasts, as reflected in the budget, indicate that the state's economy will perform more poorly than expected in its earlier forecast. This downward revision is likely to reduce workload levels below the levels that are anticipated in the budget.

In fact, the number of returns processed may actually *decline*. According to data from the FTB, the total number of returns actually processed in 1993 was approximately 1 percent less than were processed in 1992. This decline is consistent with the relative performance of the state's economy in 1993, when both real personal income and employment declined. In addition, it is uncertain what impact the recent earthquake in Los Angeles will have on economic activity and tax payment practices during 1994-95.

Therefore, until revised forecasts regarding the economy are available this May, we withhold recommendation on the $736,000 included in the budget for workload growth.

Basis for Collections and Filing Enforcement Fees Unclear

We recommend that the FTB report to the Legislature at budget hearings the basis for the Filing Enforcement and Collections fees proposed in the budget.

In 1992, legislation was enacted (Ch 699/92, SB 617, no author) which requires the FTB to collect fees from PIT and B&C taxpayers who do not voluntarily pay their tax liabilities or who do not voluntarily file tax returns. The purpose of this legislation is to fully recover the state's costs to enforce compliance on the part of these taxpayers. Fee levels are to be set annually in the Budget Bill to recover expected state costs, based on the latest information on filing enforcement actions and delinquent tax liabilities.

In the 1993 Budget Act, the Legislature directed that revenues from these fees be counted as additional General Fund revenue rather than as reimbursements in the FTB's budget. Staff at the FTB estimated that these revenues would generate approximately $26 million during 1993-94 and annually thereafter.

Budget Estimate of Fee Shortfalls Too High. According to FTB staff, revenues collected from these fees to date are 5 to 10 percent below forecast. Based upon this performance, it appears that fee revenues will be about $23.5 million in 1993-94, or approximately $2.5 million short of recovering FTB's filing enforcement and collections costs.

The proposed budget, however, reflects revenues of only $15 million in 1993-94 and 1994-95, a shortfall of approximately $11 million in both years. According to staff at the Department of Finance, this estimate is based on actual collection data for the current year. FTB staff indicate, however, that this data is suspect due to problems associated with the implementation of new computer systems.

Fee Shortfalls Should Lead to Higher Fees. Regardless of this inconsistency in revenue estimates, it is clear that the levels of the filing enforcement and collection fees proposed in the budget are identical to those adopted in the 1993 Budget Act, and that those fees are not sufficient to recover the board's cost. Existing law clearly requires the fees to be set at that level.

Therefore, in order to enable the Legislature to establish an appropriate fee level, and to ensure that the correct level of revenue is reflected in the budget, we recommend that the FTB report at budget hearings as to its estimates of filing enforcement and collections costs in the budget year. In addition, the FTB should report the fee levels necessary to recover these costs in the budget year.

DEPARTMENT OF GENERAL SERVICES (1760)

The Department of General Services (DGS) is responsible for: (1) providing a broad range of support services to operating departments and (2) performing management and oversight activities related to support services. It provides these services primarily through two programs: statewide support and property management services.

The Governor's Budget proposes expenditures of $594 million from various funds ($12.2 million from the General Fund) to support the activities of the DGS in 1994-95. This reflects an increase of $15.3 million, or 2.6 percent, above estimated current-year expenditures. Of the $594 million, about 33 percent ($194 million) of the department's costs are funded from direct appropriations, with the balance— 67 percent ($400 million) being funded from amounts appropriated to other state entities for payment to the DGS for providing goods and services.

Statewide Support Services. Expenditures for statewide support services are $354 million in the budget year, representing an increase of $8 million, or 2.3 percent, above estimated current-year expenditures. The $8 million reflects a *net* increase, because several one-time expenditures occurring in the current year will not occur in the budget year. In fact, the proposed budget for statewide support services includes $19 million in new spending proposals. These include the replacement of fleet vehicles ($6 million), reimbursement of local agencies and payments to telephone companies for the emergency telephone (9-1-1) program ($4.7 million), an increase in installment payments for the California Network System (CALNET) ($2.7 million), the replacement of microwave equipment ($2.1 million), increased staffing to provide telecommunication engineering services to client agencies ($1.7 million), and funds to pay printing contractors on behalf of state agencies using their services ($1 million).

Property Management Services. Proposed budget-year expenditures for property management services are $223 million, which is $7 million, or 3.2 percent, above current-year levels. This increase is primarily due to the costs of operating and maintaining three new state buildings and for salary increases and the cost of the personal leave program. General Fund spending for property management services will increase by $5.6 million in 1994-95 to fund hazardous materials abatement programs within the Division of the State Architect. The General Fund is replacing $5.6 million in current-year funding for these programs which came from the Special Account for Capital Outlay (SAFCO). This is because funding for SAFCO comes from tidelands oil revenues, which are proposed to be transferred to the General Fund in 1994-95 instead of being earmarked for specific state programs.

The remaining portion of the budget—$16.7 million—is for departmental administration.

DEPARTMENTAL PERFORMANCE ISSUES

Background

The DGS was established to provide centralized support services to other state agencies. Figure 20 summarizes the department's service responsibilities.

In last year's *Analysis*, we reviewed the department's performance record, noting serious shortcomings. We pointed out a long history of concerns from the Legislature, state agencies, and private vendors, regarding the manner in which the DGS has carried out its service responsibilities. The concerns have tended to fall into three categories:

- ***Cost of service.*** Many services seem over-priced when compared to the private sector, and vendors express concerns about the cost of responding to state bids.
- ***Quality of service.*** Service is not always responsive to the needs of clients, and the quality of products purchased by the DGS is not always as good as it should be.
- ***Customer orientation.*** Because the DGS has a monopoly on many services, clients sometimes feel like captives instead of customers.

We concluded, based on our review, that the DGS' performance was coming up short, given the relatively high cost of doing business with the department. We examined why this situation existed, and discussed in detail the questions we believed the Legislature should consider when making decisions as to how to improve the delivery of state support services. These questions are summarized in Figure 21.

We concluded our review by recommending that the Legislature undertake a fundamental rethinking of how the department provides support services to state agencies. In order to do this, we recommended that the Legislature take steps to introduce competition into the state's system of support services and authorize a business audit of the services provided by the DGS. In making these recommendations, we noted a number of efforts made by the department over the years to improve its operation, but also indicated that the results have been limited and that without a fundamental rethinking of the mission of this department, the prospect for significant improvements was not good.

Figure 20

Department of General Services
Centralized Services Provided to State Agencies

Service Area	Services Provided
Statewide Support Services:	
Procurement	Central purchasing and materials management
Small and Minority Business	Activities to increase participation of targeted business enterprises in state contracts
Telecommunications	Management and operation of state's telephone system
California State Police	Protection of designated office holders; police/security for state property
Interagency Support	Printing, fleet administration, administrative hearings, mail, other business-related functions, and support to the State Allocation Board, which distributes school facilities funds
Management Services	Personnel, accounting, budgeting, records management, insurance, and other management-related functions
Property Management Services:	
Real Estate and Buildings	Real estate acquisition and sale, property and construction management, office and parking facility development, energy project development, custodial, and grounds services
State Architect	Architectural/engineering consulting, project management and inspection, plan checking, and mitigation of hazardous conditions

Little Action on Performance Budgeting

The DGS is one of four departments participating in the administration's pilot project on performance budgeting, but the budget indicates little progress toward implementation. In fact, the administration's plan for performance budgeting has not delivered promised progress.

Figure 21

What Should the Legislature Consider When Determining How to Improve Delivery of Services by the DGS?

- ✔ Which support services do state agencies actually need?
- ✔ Does the DGS have the equipment, personnel, and other organizational capabilities required to provide high quality service in a timely manner and at a lower cost?
- ✔ What are the systems required to improve service delivery (for example, performance measurement and cost accounting)?
- ✔ Can DGS be effective in delivering services when it also performs control functions relating to those same services?
- ✔ How can the DGS be shifted to focus on results, rather than process?
- ✔ How can competition be used to improve services to state agencies?
- ✔ Should the state continue to achieve social policy goals through support services programs?

When the Governor's Budget for 1993-94 was introduced, it proposed a pilot project to test performance budgeting in four state agencies. The DGS is one of the agencies selected as a pilot department (please see the Crosscutting Issues section of this chapter for our discussion of the full pilot project).

During budget hearings last year, the DGS expressed agreement with the need for fundamental change in the way the department does business, and indicated that the DGS' participation in the performance budget pilot project would facilitate such change.

Little Visible Evidence of Performance Budgeting. Aside from the development of a departmental strategic plan (which we discuss below) the only indications of the administration's performance budget pilot are three proposals that provide some administrative flexibility to the department. These proposals are contained in Budget Bill language which would provide the department's director limited authority to augment the DGS budget and make temporary loans from the Service Revolving Fund to other special funds administered by the department. In addition, the budget combines the personal services and operating expenses and equipment line items into a single line item, which would give the director additional flexibility in managing the department's budget.

Many Questions Still Unanswered. There remain several unanswered questions regarding the department's participation in the Governor's performance budget pilot project. For example, performance measures, a fundamental component of performance budgeting, have yet to be determined. An implementation schedule for the transition to a true performance budget has yet to be published. The budget does not identify the cost and funding source to implement measures the Governor has identified as essential to performance budgeting, such as comprehensive quality improvement programs and new information systems to collect, process, and report actual performance.

Progress Has Not Matched Expectations. The administration's strong promotion of performance budgeting in January 1993 has so far not been matched with the promised progress. As noted in the foregoing discussion, many essential elements regarding the DGS' participation as a performance budget pilot department remain undefined. Consequently, it is not possible to assess whether the administration will be able to comply with the Legislature's requirements for performance budgeting, which we discuss in the Crosscutting Issues section of this chapter.

Department's Efforts to Improve Performance

The DGS has recently taken a number of steps designed to improve the department's performance. Although fundamental changes to make the department more cost-effective and responsive to its customers are possible, they are not easy to implement.

Strategic Plan Developed. In establishing its performance budgeting pilot project the administration required that each pilot department have a strategic plan. The DGS, in response to this requirement, employed a private consulting firm to help it develop a plan. Released in January 1994, and covering the years 1994-1998, the plan aims at fundamental changes in the department's approach to doing business in each of the DGS' 22 operating units and offices. The plan contained six primary goals, as shown in Figure 22. According to the department, it will seek to remove unnecessary controls it imposes on its customers, and ones imposed by external sources (for example, the Legislature and control agencies such as the Department of Personnel Administration). The activities identified for the 22 units and offices are intended to enable the DGS to meet the six primary goals.

Figure 22

Goals of the Department's Strategic Plan

- ✔ Achieve an ever-increasing level of customer satisfaction.
- ✔ Provide high quality products and services at competitive prices.
- ✔ Achieve increased accountability for performance.
- ✔ Provide leadership to initiate changes in the state's business practices and services.
- ✔ Communicate effectively with stakeholders.
- ✔ Use efficient and effective processes and technologies.

Proof of Fundamental Change Will Take Time. A number of the activities listed in the strategic plan have already been initiated. However, according to the plan, many of the objectives reflecting fundamental change will take several years to realize. The department, in releasing the plan, has committed to providing the Legislature and the administration with quarterly updates which will report on actual performance. According to the department, the first such report will cover the first quarter of 1994-95.

Some Innovative Initiatives are Occurring. While it is going to take some time to determine the extent to which performance budgeting and a strategic plan enable the department to make fundamental changes in its operations, we are seeing some positive indications in several areas.

For example, the department plans to open "teleconferencing" facilities in Los Angeles, Sacramento, and San Francisco this spring, to enable meetings to be held electronically at a net cost significantly less than that which would otherwise occur, because travel expenses and nonproductive time associated with travel would be almost eliminated.

The DGS is also actively working with other state agencies to pilot test "electronic commerce," a business method being deployed increasingly in the private sector which allows costly paper-based transactions, such as ordering, invoicing and payment, to be handled electronically via computers and communication lines. The DGS believes that the implementation of electronic commerce in state government will not only save millions of dollars annually, but will enable the state to process payments much more quickly and accurately, thereby addressing a frequent complaint from businesses providing goods and services to the state.

Other initiatives under way in the department include a pilot project to test the use of credit cards for small purchases and possible intergovernmental partnership arrangements to explore opportunities for consolidating operations (for example, printing).

Fundamental Change Is Possible But Not Easy. Making fundamental changes in the department in order to become more responsive to customer needs will not be easy for a number of reasons. These include institutional resistance to change, the relatively long lead time to implement significant change, and the potential difficulty to maintain top management commitment because top management is itself always subject to turnover. Nevertheless, it is clear that current management is committed to fundamental change, and that it has set a course for the department which, if followed, offers a significant opportunity for improvement in the DGS.

EXPENDITURE ACCOUNTABILITY ISSUES

Legislature Should be Advised of Post-Budget Augmentations

We recommend adoption of Budget Bill language requiring that augmentations made to the DGS' budget by the Directors of General Services or Finance be reported to the Legislature at the time they are approved.

Expenditure Cap Did Not Produce Intended Results. In enacting the 1993 Budget Act, the Legislature reduced the amount which had been requested by the DGS in order to cap expenditures at the 1992-93 level. At the time this decision was made, the DGS management provided no indication to the Legislature that the department would be unable to operate within this expenditure limit. The reduction in the department's budget was made in the form of an unallocated reduction of $11.5 million to the Service Revolving Fund, and the DGS subsequently allocated the reduction to various program areas. However, the DGS' budget was also augmented during the current year pursuant to Provision 1 of the 1993 Budget Act, which authorizes the Director of Finance to augment certain budget items so that the department is able to meet unanticipated requests from clients for which the DGS will be reimbursed. There is no requirement that these augmentations be reported to the Legislature. The amount of Provision 1 augmentations totaled $12.3 million as of December 1993, and the Governor's proposed budget indicates that the department's total expenditures for 1993-94 will exceed by several millions the cap the Legislature believed it was imposing on the department.

In discussing this issue with the DGS and the Department of Finance, it is apparent that the administration interpreted the spending cap and Provision 1 as mutually exclusive, and therefore believed that the Legislature's intent had been satisfied. Consequently, the administration did not seek clarification before authorizing augmentations which resulted in the DGS exceeding the cap, because it saw no conflict in its actions.

Administration Should Report Augmentations. The 1994 Budget Bill contains two provisions which permit the administration to augment the budget for this department in cases where the Legislature has approved funds for services or equipment in the budgets of client departments. The first provision (Provision 1 of the Budget Bill) allows DGS to augment its budget by up to 10 percent so long as the Department of Finance is notified within 15 days of the augmentation. The second provision (Provision 2) permits the Director of Finance to augment the DGS' budget beyond 10 percent to accommodate unanticipated requests from clients for which the DGS will be reimbursed.

Our analysis indicates that these provisions are reasonable because they provide appropriate expenditure flexibility. However, in light of the situation which occurred in the current year regarding augmentations, we believe that the Legislature should be advised of such augmentations. Thus, we recommend the adoption of the following Budget Bill language:

> Any augmentation made pursuant to Provisions 1 or 2 of this item shall be reported in writing to the chairpersons of the fiscal committees and the chairperson of the Joint Legislative Budget Committee within 15 days of the date the augmentation is approved. This notification shall include the amount, justification, and program which has been augmented.

Proposal Would Allow Poor Management to Go Uncorrected

We withhold recommendation on $964,000 proposed for the payment of printing work ordered by client departments, pending the department's consideration of more timely methods to pay outside printers.

Background. In general, state agencies which have printing requirements that they are unable to fulfill in-house must go through the DGS in order to have the work performed. If the DGS is unable to do the work due to short time frames or specialized needs, the department sends the work to various private sector printers. When the work is completed, the private printer delivers the finished product to the client agency, but submits the invoice to the DGS, which sends it to the client agency for payment.

Budget Proposal. The budget proposes $964,000 to enable the DGS (instead of client agencies) to make payments directly to printers for work requested by client departments. The DGS would then charge each client agency for the amount it paid the printer, plus a DGS administrative handling cost, and send the client agency an informational invoice. According to the DGS, this funding is needed because some state agencies do not make timely payment for private printing work, resulting in many complaints from private printers.

Poor Management Practices by Other State Agencies. Although we understand the department's objective, we believe that state agencies should be held accountable for *their payment practices*, and that a poor payment record reflects a management problem which needs to be addressed and corrected, rather than worked around by having the DGS assume payment responsibility. We believe that the DGS has the right objective in sight with the proposal, but that it may be able to go one step further and remove itself from having to intervene on behalf of state agencies which have poor payment practices. For example, this could be accomplished by establishing commercial credit card accounts for state agencies and providing a credit card charge authorization to an outside printer when the DGS places an order on behalf of a client agency. The charge could then be posted by the printer when the order is filled.

Before the Legislature approves this request, we believe that the DGS should explore other possible ways to achieve the proposal's objectives. Thus, we withhold recommendation on the $964,000 proposed to pay for printing work on behalf of client agencies, pending receipt and review of the department's analysis of other options for obtaining prompt payment for work provided by private printers.

CALIFORNIA STATE POLICE ISSUES

Duties and Funding of State Police Should Be Realigned

We recommend adoption of supplemental report language requiring that the DGS (1) review and realign the assignments and activities of California State Police (CSP) officers to be more consistent with the primary purpose of the CSP as prescribed by statute, and (2) determine and implement a more appropriate method of funding the activities of the CSP. We further recommend that the department accomplish these changes so that they are reflected in the Governor's proposed 1995-96 budget.

Background. The CSP is one of the more visible of the DGS' many responsibilities. The primary purpose of the CSP is to provide police services to protect state property, buildings, and their occupants. The CSP is also given authority to provide protective services to constitutional officers, current and former members of the Legislature, and current and former members of the California Supreme Court, as these services may be requested. The budget proposes $28.8 million and 409 personnel years for support of the CSP in 1994-95, which are approximately the same levels estimated for the current year.

Our review of the CSP budget indicates that CSP officers perform a variety of duties, many of which do not appear to be closely aligned with those prescribed by statute, and that the primary method of funding the CSP—a pro rata charge paid by departments—is fundamentally unsound.

Focus Should Be On Essential Responsibilities. In reviewing the department's proposed budget for the CSP, it became apparent that the number of officers employed by the CSP and their assigned duties are not necessarily related to the state's needs as expressed in statute (to protect and provide police services for state property, buildings, and occupants). Certain duties performed by the CSP, such as internal building security, have increasingly been assumed by client agencies, usually through contracts with private security firms. While this has freed up CSP officers to perform other duties, a review of CSP activity reports indicates that some activities performed by the CSP are ones typically performed by local police, such as the enforcement of traffic laws on public streets and highways. Moreover, as discussed below, certain other functions performed by the CSP, such as contract work for nonstate agencies (as discussed in the next issue) do not appear to be related to the primary purpose of the CSP as defined in statute. For these reasons, we believe that the DGS should review the CSP's statutory basis and realign the number of staff and the duties they perform in a manner which is more consistent with statute. We believe that it is quite likely that in so doing, the department will find that it can either reduce the size of the police force or reassign officers to higher priority tasks.

Current Funding Mechanism Needs Overhaul. The primary funding source for the CSP is a "pro rata" charge assessed to state agencies which is based on office and parking space. The budget anticipates $24.6 million in assessments in 1994-95. As it is constructed, the current method is inappropriate because:

- The pro rata charge bears absolutely no relationship to services provided.
- Certain state agencies which sometimes request and receive CSP services are *exempted* from the pro rata charge. Exempted agencies, for example, include the University of California, the California State Lottery Commission, and the Military Department.
- State agencies have no option but to pay the pro rata assessment. This guaranteed funding provides no incentive to the DGS to align the CSP funding and staffing in a manner which is more consistent with actual need.

The current arrangement results in assessments to agencies that make virtually no sense. For example, the pro rata assessment to the Board of Equalization increased by $214,000 annually, or 62 percent, when the board consolidated its operations into a new building simply because it had more office space than the previous locations combined. However, as the board does not use the CSP for building security, and is now in one building instead of several, the CSP has even less board area to patrol on a drive-by basis.

Analyst's Recommendation. In his cover letter transmitting the department's strategic plan, the Director of General Services noted the plan's emphasis on "satisfying customers by providing more timely services at competitive rates." The plan is very clear in reflecting repeatedly the department's customer-oriented vision statement. Clearly, the current method of charging "captive" state agencies for the CSP services is, in addition to being inequitable, also inconsistent with the department's stated direction. For these reasons, we believe that the DGS should determine and put into operation a more suitable method of funding the CSP.

Specifically, we recommend the following supplemental report language:

> The department shall (1) review the operation of the California State Police (CSP) and, where appropriate, realign its assignments and activities to be more consistent with the primary purpose of the CSP as prescribed by statute, (2) determine and implement a more appropriate method of funding the activities of the CSP, (3) accomplish the foregoing so that the results are reflected in the Governor's proposed 1995-96 Budget, and (4) report the specific measures it has taken, or plans to take to accomplish the foregoing, to the chairpersons of the fiscal committees and the chairperson of the Joint Legislative Budget Committee by December 30, 1994.

Proposed Positions Inconsistent With Statutory Mission

We recommend deletion of $112,000 and two new CSP officer positions because the duties the officers will perform are not consistent with the CSP's primary statutory responsibility.

The budget requests $112,000 from the Service Revolving Fund for two new CSP officers in order to provide contractual services to Caltrans and the 32nd District Agricultural Association.

The CSP has redirected two officers and administratively established one additional officer position in order to perform investigative work for Caltrans relating to discrimination complaints. The proposed budget would continue the administratively established position. The other position requested is for a lieutenant to oversee the security needs of the 32nd District Agricultural Association (Orange County).

Our review indicates that neither of the two proposed positions is consistent with the primary purpose of the CSP as stated in current law, which is to protect and provide police services for state property, buildings, and occupants. For that reason, we recommend deletion of $112,000 proposed for two new officers.

DIVISION OF THE STATE ARCHITECT ISSUES

Seismic Program—State Buildings

We recommend deletion of $1.5 million in bond funds for building evaluations because the bond funds should instead be used to retrofit

state buildings for earthquake safety. Delete $1.5 million in Item 1760-001-768.

Background. The Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990 provided $250 million for safety-related renovations of state buildings. About $195 million of these monies remain available for appropriation by the Legislature.

In 1990-91, the Division of the State Architect (DSA—formerly the Office of the State Architect) began a survey of state buildings to determine priorities for correcting seismic and other safety hazards. The survey is being financed with bond proceeds from the 1990 Act. In the initial steps for this program, the DSA developed criteria for ranking buildings in priority for corrective work and distributed a survey instrument to state agencies to obtain information on about 14,000 buildings.

Status of Program. The DSA has received completed surveys for about 7,000 buildings. This covers all state buildings having significant numbers of occupants. In evaluating the survey results and using the priority criteria, the DSA will identify 300 to 400 buildings that they believe will require more intensive architectural/engineering investigation. In the *1991 Budget Act*, the Legislature provided $1 million in bond funds for the DSA to contract with consultant architects and structural engineers to study specific buildings and develop seismic retrofit schemes, including cost estimates. At the time this analysis was written, the DSA had contracted for 28 building evaluations. The DSA estimates that a total of 50 to 60 buildings determined to be potentially most in need of seismic retrofit can be studied with the $1 million.

Budget Proposal and Analyst's Concerns. The DSA proposes to spend an additional $3 million in contract funds to evaluate another 150 buildings. The $3 million includes $1.5 million submitted as a deficiency request in the current year and $1.5 million included in the 1994-95 budget. We believe that these bond funds should be used to make improvements to state buildings rather than to pay architects/engineers to evaluate more buildings. At the time this analysis was written, the DSA had received completed consultant studies on only six buildings. The estimated cost to retrofit these six buildings totals $30 million. Based on these cost estimates, the total retrofit cost for the 50 to 60 buildings to be studied with the previously appropriated $1 million is likely to exceed the $195 million in remaining bond funds. The use of these limited funds to correct hazardous conditions, rather than study them, was made especially clear by the recent Northridge earthquake. In our view, it would be imprudent for the state to spend up to $3 million in scarce bond funds for such planning purposes, as opposed to spending it on *actual improvements* on state buildings including any that may have been damaged or weakened in the Northridge earthquake. We therefore recommend that the Legislature not approve the $1.5 million requested for consultant studies in 1994-95.

If the additional funds for studies are not approved by the Legislature, the DSA will not need to use staff time for awarding, administering, and evaluating additional consultant contracts beyond those already funded and scheduled to be completed in the current year. Therefore the DSA will need to establish a new work plan for the state buildings seismic program. The plan should include activities to be performed and tasks to be accomplished and staffing and budget requirements for 1994-95. The DSA should provide this plan to the Legislature prior to budget hearings.

Bonds Should Be Used for Earthquake Safety Improvements

We recommend that the Legislature adopt Budget Bill language clarifying that priority for the use of these bond funds is for seismic-related building improvements.

The 1990 bond act made $250 million available for the costs of "retrofitting...state buildings which are seismically unsafe or have other safety deficiencies." As discussed above, the six building studies that have been completed have cost estimates totaling $30 million, which includes *only structural retrofit costs for earthquake safety*. The DSA has indicated that in addition to the earthquake safety retrofit work, it plans to include costs to bring buildings up to *current* fire and life safety and disabled access building code requirements. Thus, the cost to make all improvements envisioned by the DSA for just these six buildings would be *significantly higher* than $30 million.

Because building codes are regularly revised, and in general made more stringent, most buildings *do not* meet current code standards. Buildings are normally brought up to current standards in conjunction with major renovations that are undertaken to address programmatic needs. Thus, given the limited amount of earthquake bond funds, using these funds to make buildings meet nonstructural issues will greatly diminish the number of state buildings for which *seismic safety* can be improved. We therefore recommend that the Legislature adopt the following Budget Bill language to establish seismic retrofit as the priority for use of these bond funds and to restrict other code-related improvements to those that are made necessary by the seismic retrofit work.

> Item 1760-001-768. Provision 1. State building capital outlay projects to be funded from the Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990 shall only provide for structural retrofit of seismic deficiencies, including the abatement of falling hazards, and for other building modifications if the other building modifications are needed solely

to accomplish the structural retrofits. This does not apply to projects previously authorized by the Legislature for funding from this bond act.

Additional Architectural/Engineering Staff Not Needed

We recommend that the Legislature not authorize additional architectural/engineering staff because workload increases can be addressed with consultant contracts. We also recommend that the Legislature modify proposed Budget Bill language to prevent the Division of the State Architect from adding staff not authorized by the Legislature. (Delete $628,000 in Item 1760-001-602.)

The budget requests an additional $628,000 (7.8 PYs) for the DSA's Architecture and Engineering Services section for 1994-95. This section provides architectural, engineering, and construction support services for state capital outlay projects and some special repair/deferred maintenance projects. According to the DSA, the additional staff is needed to accomplish anticipated workload for 1994-95.

Since 1987, the responsibility for managing the design and construction of major capital outlay projects (those with a total cost over $250,000) has rested with the Office of Project Development and Management (OPDM) within the Department of General Services (DGS). As part of this management responsibility, the OPDM, in consultation with the DSA, determines which projects will be designed by the existing staff at DSA and which projects will be contracted out to private design consultants. This practice allows the state to more efficiently manage fluctuations in workload and prevents the need for layoffs when workload decreases. The department has not indicated that there have been any changes in this arrangement. We do not believe, therefore, that the DSA should be authorized to increase permanent staff because design work that cannot be accomplished by existing DSA staff can be (and historically has been) contracted out. In conclusion, we recommend that the Legislature not approve the $628,000 and 7.8 PYs requested for 1994-95.

Modify Budget Language. A majority of the DGS's operating funds consist of payments from other departments for services rendered by the DGS. The budget bill includes language that allows the DGS to augment its budget if the Legislature approves funding for a client department for DGS-provided services and the corresponding expenditure authority has not been provided in the DGS budget. Under a similar provision in the *1993 Budget Act*, the DGS augmented the DSA's design staff by 7.3 PYs. As discussed above, fluctuations in workload for design should be addressed by the historical practice of contracting for work that cannot be accomplished with existing staff. In order to prevent future augmentation of the design staff, we recommend that the Legislature add the following Budget Bill language under Item 1760-001-666, Provisions 1 and 2:

The Department of General Services shall not use this authority to increase the number of positions in the Division of the State Architect, Office of Design Services.

OFFICE OF BUILDINGS AND GROUNDS ISSUES

Maintenance Service for New State Buildings

We recommend that the DGS clarify its intent for operating and maintaining three new state buildings using either private firms or DGS staff.

The budget requests $3 million (48.9 PYs) in additional expenditure authority for the Office of Building and Grounds (OBG) to provide maintenance and janitorial services for the following new state office buildings in Sacramento:

- Capital Square Building—$1,354,000 (29.4 PYs). This building is currently occupied by the State Board of Equalization. Effective January 1, 1994, the state exercised a purchase option for this building.
- State Library Annex—$633,000 (7.2 PYs). Construction of this building is scheduled for completion in May 1994.
- Secretary of State/State Archives Building—$984,000 (12.3 PYs). This building is scheduled for completion in February 1995.

The three budget proposals request authorization for new positions within the OBG. It is our understanding, however, that the department instead intends to solicit proposals for private firms to provide operating and maintenance services for each of the three buildings. In fact, a proposal for maintaining the Capital Square Building is to be solicited and evaluated this spring. We believe that such competition might allow the state to receive these services at less cost than if the work is performed by the department. We therefore recommend that the department clarify its intentions at budget hearings.

Building Rental Account

We recommend modification of Budget Bill language to allow any year-end balance in the Building Rental Account to be used for special repair/deferred maintenance projects instead of being transferred to the General Fund. We also recommend that the Legislature adopt supplemental report language stating its intent that the building rental rate be increased in 1995-96 to a level sufficient to address the department's deferred maintenance backlog. Finally we recommend that the Legislature adopt Budget Bill language that increases the department's base funding for special repairs to $2.2 million.

Deferred Maintenance Backlog. State agencies that occupy state-owned office and warehouse space controlled by the Department of General Services pay into the Building Rental Account (BRA) for the statewide costs of operating and maintaining that space. (The DGS has established a rental rate for state office space of $1.36 per square foot per month for the budget year—a two-cent increase from the current year.) Part of building maintenance costs are for special repairs. These are maintenance repairs—such as roof replacements—that are required periodically and are above the base level of expenditures needed for routine ongoing maintenance. When ongoing maintenance and special repairs are not accomplished as needed, a backlog of "deferred maintenance" is created. This has occurred within state buildings managed by the DGS. The department estimates that deferred maintenance in these buildings now totals $31 million.

In accordance with the Supplemental Report of the 1993 Budget Act, the DGS submitted a maintenance/deferred maintenance plan to the Legislature in December 1993. The plan proposes that the department maintain a base level of $2.2 million for special repairs (current base level is $631,000) and augment this with about $3 million annually to eliminate the current deferred maintenance backlog over the next ten years.

Budget Proposal. For special repairs, the Governor's Budget maintains the $637,000 base and proposes one-time additional expenditures of $2.2 million. The budget-year total of $2.8 million is about equal to that provided in each of the previous three fiscal years. The proposed level does not provide the DGS with funding necessary to begin eliminating the deferred maintenance backlog in state buildings. Constant deferring of needed maintenance will eventually require more expensive emergency repairs (when systems break down) or capital improvements, such as major rehabilitation or replacement. In order to allow the DGS to begin addressing this deferred maintenance backlog, we make three recommendations as presented below:

- ***Increase Baseline Funding.*** Given the rather rapid accumulation of deferred maintenance, it is clear that the department's $631,000 base budget for special repairs is too low. The DGS has reported to the Legislature that to properly maintain its 4.5 million square feet, the base funding for special repairs should be increased to $2.2 million. We concur with the DGS' conclusion. Therefore, we recommend that the Legislature endorse the need for this level of funding through the following supplemental report language.

It is the intent of the Legislature that the department's base level of special repair expenditures for 1994-95 shall be $2.2 million.

- ***Use Excess BRA Revenues***. For several years, the budget has included language requiring the DGS to transfer to the General Fund excess revenues remaining in the BRA at the end of fiscal year. For the past five years, this transfer has averaged about $600,000. We recommend that the Legislature modify this language to require the

DGS to use any excess revenues, from both the current year and the budget year, for the deferred maintenance backlog.

1760-001-666. Provision 3. Notwithstanding Section 16422 of the Government Code, the balance of any rental receipts paid into the Building Rental Account of the Service Revolving Fund as of June 30, 1994, after accounting for all receipts and the fiscal year 1993-94 costs of maintaining, operating, and insuring buildings included within the account, shall be reported to the Joint Legislative Budget Committee no later than September 30, 1994 and shall be used to complete high priority projects as identified in the Department's "Maintenance and Deferred Maintenance Plan", December 1993.

Notwithstanding Section 16422 of the Government Code, the balance of any rental receipts paid into the Building Rental Account of the Service Revolving Fund as of June 30, 1995, after accounting for all receipts and the fiscal year 1994-95 costs of maintaining, operating, and insuring buildings included within the account, shall be reported to the Joint Legislative Budget Committee no later than September 30, 1995 and shall be used to complete high priority projects as identified in the Department's "Maintenance and Deferred Maintenance Plan", December 1993.

- ***Increase Building Rental Rate.*** The building rental rate should be increased to a level sufficient to provide the DGS with $3 million per year to address its deferred maintenance backlog. This would require an increase of about five cents per square foot per month. Recognizing that such an increase has not been built into state departments' budgets for 1994-95 and that departments will continue to experience budget pressures, we recommend that the Legislature adopt the following supplemental report language stating the intent that the rate be increased in 1995-96.

It is the intent of the Legislature that the department increase the building rental rate for 1995-96 by an amount sufficient to address its deferred maintenance backlog, as proposed in its "Maintenance and Deferred Maintenance Plan", December 1993, and to use the rental revenues associated with this increase solely for financing the deferred maintenance identified in that plan.

OTHER STATEWIDE SUPPORT SERVICES ISSUES

Improving Replacement of Fleet Vehicles

We recommend the adoption of supplemental report language requiring that the DGS evaluate its current approach to vehicle fleet management and report to the Legislature, by December 30, 1994, on its findings and recommendations to improve the cost-effectiveness of fleet operations.

The department plans to spend $12 million in the current and budget years ($6 million each year) to acquire new vehicles to replace high-mileage or wrecked vehicles. This expenditure would allow the Office of Fleet Administration (OFA) to purchase approximately 1,400 new vehicles, for a total fleet of about 5,000 vehicles, which would enable the department to maintain a traditional level of service to customers.

While we have no basis for recommending against this expenditure, our review of the department's proposal suggests that there may be opportunities to reduce future fleet costs and at the same time provide a better level of service and achieve a higher degree of conformance with the state's general interest in fuel conservation and environmental quality.

Specifically, we believe that these benefits could be obtained by:

- Expanding bidding opportunities to allow more manufacturers to be considered than has been the practice.
- Considering a manufacturer's historical quality record when evaluating bids.
- Acquiring smaller and more fuel-efficient vehicles which could be used in the state's major metropolitan areas.

Competition and Quality Records. In conducting bids for fleet vehicles, the department's bid specifications preclude foreign manufacturers. According to the department, this exclusion results from state law pertaining to a preference for buying only American-made products. It is not clear, however, whether the department's interpretation of what constitutes "American-made" is appropriate, because neither the law nor the department has defined "American-made" regarding the state's purchase of vehicles. Given the number of foreign manufacturers who have established assembly facilities in the United States, we believe that the department should review its definition to determine whether it is consistent with current law.

According to the OFA, the historical quality of a manufacturer's vehicles is currently not a consideration in vehicle purchases made by the state. Clearly, the quality of manufacture is an important factor influencing the useful life of a vehicle. For that reason a manufacturer's quality record may be an appropriate consideration in evaluating bid proposals.

Why Not Sub-Compacts? The OFA currently does not acquire sub-compacts for the state's fleet. Given the exceptionally high fuel efficiency of some of the sub-compacts, the use of such vehicles in congested urban areas would contribute to the state's general fuel conservation and clean air goals. The use of sub-compacts could also result in a less costly fleet, provided that their repair record compares favorably to that of compacts, because their purchase price would be less. Sub-compacts are admittedly not suitable for all occasions or even all drivers, but that should not rule out their consideration entirely.

Analyst's Recommendation. Based on the above, we recommend that the Legislature adopt supplemental report language requiring the department to report by December 30, 1994, on possible improvements in its fleet operations. Such a report should include a review of opportunities to expand bidding opportunities to include more manufacturers and consideration of a manufacturer's quality record, and opportunities to acquire smaller and more fuel-efficient vehicles.

Specifically, we recommend the following language:

> The department shall report to the Legislature by December 30, 1994, as to possible methods to improve the cost-effectiveness of its vehicle fleet, and the department's recommendations for implementing such methods. The report shall specifically address, but not be limited to: (1) methods for expanding competition by allowing the consideration of additional vehicle manufacturers, (2) consideration of manufacturing quality records in evaluating bids, and (3) the acquisition of sub-compact vehicles.

DEPARTMENT OF FINANCE (8860)

The Department of Finance (DOF) advises the Governor on the fiscal condition of the state, assists in developing the Governor's Budget and legislative programs, evaluates the operation of state programs, and provides economic, financial, and demographic information. In addition, the department oversees the operation of the state's accounting and reporting systems and the state's use of information technology.

The Governor's Budget proposes expenditures of $27.5 million ($21 million from the General Fund) to support the activities of the DOF in 1994-95. This reflects an increase of $770,000, or 2.9 percent, above estimated current-year expenditures. The proposed budget is essentially a workload budget.

Fundamental Problems With State's Information Technology Programs

We withhold recommendation on $2 million proposed to fund the operations of the Office of Information Technology (OIT), pending further evaluation of the OIT.

The budget proposes $2 million for support of the OIT in 1994-95. The OIT has statutory authority to oversee the state's uses of information technology. This is a significant responsibility, given that statewide expenditures for information technology programs exceed $1 billion annually. To carry out its responsibility, the OIT has focused primarily on a highly structured process within which information technology projects are proposed, approved, and implemented. This process, contained in the State Administrative Manual, requires specific plans and reports regarding the expenditure of funds for information technology projects, to be submitted to the OIT for review. The OIT has also published various guidelines intended to help state agencies to apply information technology cost-effectively, including its recent "Strategic Direction for Information Technology in California State Government 1993-1999."

Although we find that the state has made much progress in applying information technology effectively, a review of recent major information technology projects, which we discuss in various sections of this *Analysis,* raises serious questions as to the OIT's role in ensuring the state's cost-effective application of information technology. (Please see our analyses of the Departments of Social Services and Motor Vehicles, the Stephen P. Teale Data Center, and the Board of Equalization.)

Review Will Address the Magnitude of the Problem. We believe that the information technology issues discussed throughout this *Analysis* are representative of serious, fundamental, problems with the manner in which the state plans and implements major information technology projects. We also believe that these projects which are experiencing difficulties represent only the visible "tip of the iceberg" of deficiencies in the state's information technology program. For that reason, we are conducting a review of the state's information technology infrastructure and plan to report our findings and recommendations to the Legislature in early spring, at the time the OIT's budget is reviewed by the Legislature. Consequently, we withhold recommendation on $2 million requested to support the OIT pending issuance of our report.

Performance Budgeting Pilot Program

The Governor's Performance Budgeting Pilot Program being managed by the DOF has produced little in the way of tangible results and is significantly behind schedule.

In January 1993, the Governor proposed a performance budget pilot program involving four departments. The program was to have begun immediately with planning efforts conducted with the Legislature, and performance budgets submitted in 1993-94. The pilot program was subsequently enacted in statute in Ch 641/93 (SB 500, Hill) as the Performance and Results Act of 1993, which *required* performance budgets for the four pilot departments *in 1994-95*.

To date, there has been little visible progress in this program and minimal reflection of the program in the Governor's 1994-95 Budget. Because the program affects multiple agencies and the administration plans to expand it, we address the performance budget pilot program in the Crosscutting Issues section of this chapter.

CONTROL SECTION 13.90—TRANSFER OF FINANCING AGENCY BALANCES TO THE GENERAL FUND

We withhold recommendation on the proposal to transfer various special fund balances to the General Fund and recommend that the Legislature conform its action on these proposed transfers to its approval of the budget for the California Revenue Bond Financing Authority.

This section requires the State Controller to transfer the balances of five special funds to the General Fund on January 1, 1995. The funds affected support financing authorities and committees that the budget proposes for elimination or consolidation. The budget requires that a total of $18.3 million be transferred from the following funds:

- California Debt Limit Allocation Committee Fund ($740,000).
- Industrial Development Fund ($481,000).
- Mortgage Bond and Tax Credit Allocation Committee Fund ($10.3 million).
- Educational Facilities Authority Fund ($3 million).
- Student Loan Authority Fund ($3.8 million).

In the Crosscutting Issues section of this chapter we discuss the administration's proposal to consolidate these authorities into a new California Revenue Bond Financing Authority (CRBFA). We withhold recommendation on the proposed funding for the CRBFA pending the receipt of information from the administration concerning the proposed eliminations and consolidations.

The special fund balances proposed in this control section for transfer to the General Fund may be needed, at least in part, to provide additional operating funds to the CRBFA. Consequently, the Legislature should conform its actions on these proposed transfers with its decision on the CRBFA.

Under any conditions, however, the proposal to transfer $10.3 million from the Tax Credit Allocation Committee (TCAC) reserves to the General Fund is problematic. Our review indicates that the funds in the TCAC reserve represent fees paid by housing developers to pay for the ongoing costs of monitoring housing project compliance with requirements imposed by the state and federal low-income housing tax credits. In 1992, the California Attorney General issued an opinion concluding that these fees are for the exclusive use of the TCAC for carrying out these required activities—and may not be used for any other state or federal purpose. Accordingly, these monies would not be available for transfer to the General Fund.

COMMISSION ON STATE MANDATES (8885)

The Commission on State Mandates is responsible for determining whether local agency claims for reimbursement of state-mandated local costs should be paid by the state. If the commission determines that a statute or executive order contains a reimbursable mandate, the commission develops an estimate of the statewide cost of the mandated program and includes this estimate in a semiannual report. After receipt of this report, the Legislature appropriates funds in a "claims" bill to pay the newly approved mandates. Subsequent-year costs of the mandate are then funded through Item 8885.

The budget proposes expenditures of $196.2 million for 1994-95. This is $135 million, or 41 percent, less than estimated current-year expenditures. This decrease is primarily attributable to a reduction in the amount of funding expected to be required to pay for newly approved mandates in the annual claims bill.

School Crimes Reporting Mandate

We recommend that the Legislature make the School Crimes Reporting mandate optional until a reliable reporting system can be established. (Reduce Item 8885-111-001 by $902,000).

Chapter 1607, Statutes of 1984 (AB 2483, Stirling), requires school districts to report crime statistics to the State Department of Education (SDE). In 1991, the Commission on State Mandates determined that school district costs to report these data are reimbursable. The budget proposes $902,000 for school districts' costs associated with this mandate in 1994-95.

As we discuss more fully in our analysis of the Department of Education, the SDE has found unusual disparities across districts in statistics reported for the same types of crimes. To correct this problem, the Governor's Budget proposes $100,000 in the SDE budget for the redesign of the current school crime reporting system. This improved crime reporting system will take at least a year to implement.

Until the school crime data irregularities have been corrected, the data reported by the school districts are of minimal value. Accordingly, we recommend the Legislature make the school crimes reporting mandate optional in the budget-year, for a General Fund savings of $902,000. The Legislature should consider these savings in the context of its overall decision on Proposition 98 funding levels.

Costs of Deferred Mandates Not Fully Funded

The budget does not provide funds to pay the deferred prior-year costs of two mandates and double-budgets the 1994-95 cost of another mandate. We estimate the state's net unfunded mandate liability totals $21.7 million.

Over the last two years, the Legislature and administration have deferred funding for five school-related mandates, as shown in Figure 23. The budget document proposes $40.3 million in funding to pay the budget-year and prior-year deferred costs of these mandates. This amount reflects: $1.9 million (General Fund) and $18.3 million (proposed Proposition 98 reversions) included in the budget bill, and $19.9 million set-aside in the budget document for the 1994 claims bill.

Figure 23

Commission on State Mandates
Status of School-Related Deferred Mandate Claims

(Dollars in Thousands)

Mandate	Statute	Unfunded Costs through 1994-95	Funding proposed	Unfunded Costs
School Crimes Reporting	Ch 1607/84	$5,318	$902	$4,416
Civic Center Act	Ch 49/84	36,737	18,369	18,368
Emergency Procedures	Ch 1659/84	16,222	17,255	-1,033
Model Curriculum Standards	Ch 498/83	2,806	2,806	—
Exam Proctors	Ch 498/83	950	950	—
Totals		**$62,033**	**$40,282**	**$21,751**

As shown in Figure 23, the funding proposed in the budget document:

- Pays all deferred costs of the Model Curriculum Standards and Exam Proctors mandates.
- Double-budgets the payment of 1994-95 costs associated with the Emergency Procedures mandate.
- Fails to fully fund the deferred costs of the School Crimes Reporting and the Civic Center Act mandates.

If the double-budgeted funds are applied toward the unfunded costs, we find that the state's remaining unfunded liability for these mandates is $21.7 million. The administration has not indicated how or when these costs will be paid.

School Mandate Costs Overbudgeted

We recommend a General Fund reduction totalling $6.2 million in the amounts scheduled for two school mandates, because the requested amounts are over budgeted. (Reduce Item 8885-111-001 by $6.2 million.)

Chapter 1036, Statutes of 1979 and Chapter 1286, Statutes of 1980 require school districts to pay certain percentages of teachers' salaries to the Teachers' Retirement Fund. School district costs to fulfill these requirements are reimbursed annually in the budget bill.

As we discuss more fully in our analysis of the State Teachers' Retirement System, the amounts proposed in the budget for these mandates are based on highly inflated assumptions regarding the growth of statewide teacher payroll in 1992-93 through 1994-95. We estimate the actual cost of these mandates will total $6.2 million less than proposed in the budget bill. Accordingly, we recommend the amounts scheduled for these mandates be reduced as follows:

- Chapter 1036 (STRS rate increase)—reduce amount scheduled by $4.6 million,
- Chapter 1286 (STRS cost-of-living increase—reduce amount scheduled by $1.6 million.

STEPHEN P. TEALE DATA CENTER (2780)

The Stephen P. Teale Data Center (TDC) is the state's general purpose computer center, providing a variety of information technology services to over 200 state agencies. The cost of the center's operation is reimbursed fully by these client agencies.

The budget proposes $77.7 million from the TDC revolving fund for support of the center's operations in 1994-95. This is an increase of $2.6 million, or 3.5 percent, over estimated current-year expenditures. Proposed staffing of 391 positions is unchanged from the estimate for the current year.

DECISIONS RAISE QUESTIONS ABOUT DATA CENTER OPERATIONS

The data center plays a very important role in supporting many state programs through the computer services it provides its clients. Over the years, the data center has developed a strong customer orientation, and provides several effective and reliable services employing many complex technologies. During the past two years, however, the TDC has been a central figure in major computer procurements which have been controversial, and major projects for client departments where the data center's role has also been controversial. Our review of these activities has disclosed some serious deficiencies in how the data center conducts business. These deficiencies fall into three broad categories: (1) procurement, (2) fiscal management, and (3) compliance with state law and policy. The implications of the data center's business practices are significant because many state programs are dependent on services provided by the data center. We describe below the specific business practices which we believe can jeopardize the data center's viability as a competitive provider of computer services.

Procurement of New Mainframe Computer Has Cost Time and Money

The recent procurement of a mainframe computer has disclosed a number of major problems with the data center's procurement process and capacity management.

First Attempt to Sole Source a New Computer Disallowed. In January 1992, the data center attempted to acquire, on a sole source basis, a new, very large mainframe computer. The basis for the procurement was the data center's assertion that the need for additional computing capacity was, at that time, "critical." Following complaints raised by competing vendors, the Department of General Services (DGS) disallowed the sole source acquisition, and recommended that the TDC procure the computer in 1992-93 via a competitive acquisition.

In September 1993, the data center initiated another procurement for the computer it had sought to acquire in January 1992. This time, following allegations by a potential bidder that the bid procurement violated various competitive bidding principles, the data center modified the procurement so as to remove the basis for the complaint.

Second Attempt to Buy the Same Computer Results in Another Dispute. On November 10, 1993, the TDC announced its intent to award a contract for a *used* computer to the same vendor that the TDC had attempted to make a sole source award to in January 1992. On November 15, a competing bidder which had bid a *new* computer, filed notification of its intent to formally protest the proposed award, citing various alleged irregularities in the bid evaluation. State law and policy provide that when a notification of intent to protest is filed, the procurement is halted until the administrative process is completed. That process can include a hearing before a hearing officer and a final decision by the Board of Control. Bidders can also seek remedy in the courts.

Data Center Acquires the Disputed Computer Despite Protest. On November 18, 1993, three days after the TDC was advised that one of the bidders was going to protest the proposed award, the data center sought approval from the DGS to *lease, on an emergency sole source basis*, the very computer which was the subject of the protest. The data center alleged that it needed the computer for two primary reasons: (1) pressing capacity needs from its clients and (2) the need for computer capacity to meet the requirements of a contract between the TDC and the Department of Motor Vehicles (DMV), for the DMV's Network 2000 project, which we discuss below. The data center's request was approved by the DGS, and the computer was installed.

Data Center Ends Up With Costlier Solution. Our review of this procurement indicates that it resulted in a significantly more costly solution. This has occurred because, while the difference between the two lowest bidders was $46,000, the TDC will incur costs of $250,000 per month ($1.5 million over the six-month period) to lease the computer. In addition, the leased computer required special equipment connections resulting in additional costs of several hundred thousand dollars.

Was There a "Critical" Need for the Computer? Our review further suggests that the grounds on which the data center obtained approval for the emergency sole source lease of the disputed computer are questionable. Specifically, the data center has, over the years, invested heavily in specialized software and highly trained staff to enable it to manage its capacity needs with some precision so as to avoid running out of capacity. In *February 1992*, the Director of the TDC advised the DGS that the need for the new computer was at that time "critical." Yet, the data center managed to process its client's workload without the new computer until *November 1993* when, citing critical capacity requirements, it obtained approval for the emergency lease.

Conclusions. The manner in which the data center has managed its capacity needs and conducted a procurement to satisfy those needs resulted in an overly costly solution. This could have been avoided by applying its capacity management tools more effectively, and conforming more closely with the intent of state law and policy which overwhelmingly favor open competition for state business.

Network 2000: A Great Deal for the DMV

The data center's contract with the DMV for the Network 2000 project is not fiscally sound and has subjected the data centers' clients to a $5.5 million liability for which they have not been funded.

Data Center Enters Into a Losing Contract. "Network 2000" is a DMV project to establish a new computer-based capability to handle electronic queries of the DMV databases that originate in other state agencies or the private sector. The DMV initiated this project because its current system is out-moded and has limited the DMV's ability to accommodate an increasing workload. Subsequent to the DMV's release of its Request for Proposal to hire a contractor to implement Network 2000, the TDC and two prominent information technology service providers from the private sector emerged as active competitors for the Network 2000 contract award. In August 1993, shortly before final bids were due, the DMV advised potential bidders that it would consider no bid which exceeded $18.8 million. On August 30, 1993, the TDC submitted a bid of $6.5 million. Neither of the private sector vendors submitted a bid. The TDC bid was found to contain an error, and as a result the contract awarded to the TDC was for $5.5 million.

Data Center Pays Too Much For Contract With DMV. Our review indicates that the TDC's bid for the Network 2000 project is financially unsound and has exposed all other data center clients to a potential fiscal liability for which they have not been funded.

The bid is unsound because the data center's own analysis of the costs and revenue associated with its bid for Network 2000 demonstrates that the true costs to the TDC to perform the contracted work will exceed by several millions of dollars the guaranteed revenue to be received from the DMV over the five years of the contract's life. As a consequence, the data center's other clients will, in effect, subsidize the DMV through rates they pay because the data center has no other source of revenue to make up the difference.

Furthermore, the TDC's bid has exposed all clients, except the DMV, to an unfunded liability because in signing the contract the TDC agreed to *liquidated damages* equal to the maximum amount of the contract—$5.5 million. Consequently, if for some reason the TDC is unable to perform in accordance with the contract, and the DMV enforces the liquidated damages provision, the data center's other clients would have to make up the cost through the fees they pay for TDC services. When all of these factors are considered, the TDC has in fact "paid" too much for the Network 2000 contract because its cost to meet the DMV's requirements will exceed by a wide margin the revenue it will receive pursuant to the contract.

Other Problems With the Contract. Our review of the contract between the data center and the DMV for Network 2000 discloses two other serious deficiencies. First, in agreeing to charge the DMV a maximum of $5.5 million over the life of the contract, the data center has failed to comply with long-standing state policy (State Administrative Manual Section 8752) requiring state agencies to recover the full costs of services provided to other departments. In addition, we have determined that when the data center proposed its bid to the DMV in August 1993, it apparently had not done a proper analysis of the bid's cost and revenue implications, because when we requested this analysis in November 1993, we were told that it did not exist in a form which could be shared. The data center was unable to provide the analysis until January 1994. While the data center's analysis reflected a break-even in 1998-99, that premise was based on *anticipated* additional revenue of $7.5 million, whereas the contract with the DMV guarantees a maximum of $5.5 million.

Non-Competitive Rates Can Drive Clients to Non-Data-Center Alternatives. The data center's ability to remain competitive is in essence reflected in the rates it charges its customers for the work it performs on their behalf. Where these rates are higher than they should be due to excessively costly procurements, or non-competitive contracts such as that between the data center and the DMV, the difference between the cost of doing business with the TDC and the cost of non-data center alternatives narrows. This is especially important given the current trend away from large, central data center-based solutions to ones which are departmental-based. Consequently, practices which result in uncompetitive rates can cost the data center its customers.

Network 2000 Contract Needs to Be Renegotiated

We recommend that the Legislature adopt Budget Bill language requiring the data center to renegotiate its contract for the Network 2000 project with the DMV to ensure that the data center is reimbursed for its true cost of providing these services, and that the data center's other clients are not impacted adversely by the contract.

As discussed above, the contract with the DMV for the Network 2000 project is simply not a good business proposition. In order to ensure that all data center clients are billed for services consistent with established state administrative policy, and that they are not subjected to fiscal liability for which they are not funded, we recommend Budget Bill language requiring that the contract with the DMV for the Network 2000 project be renegotiated. The DMV was willing to pay up to $18.8 million for the work to be performed, and for that reason should not be averse to negotiating a more appropriate contract for the interests of the state as a whole. Consequently, we recommend the following Budget Bill language be adopted:

> The data center shall re-negotiate its contract with the Department of Motor Vehicles (DMV) for network services provided in response to the DMV's Request for Proposal RFP DMV-2046 to ensure that (1) the data center recovers its full cost of services provided the DMV consistent with State Administrative Manual Section 8752 and (2) the liquidated damages provision of the contract is removed in order that none of the data center's other clients will incur a financial liability for any failure on the part of the data center to perform under the contract.

Is Bigger Always Going to be Better?

The data center's continued emphasis on mainframe computers comes at a time when mainframe sales are shrinking nationally because of a growing trend toward alternative computing methods.

Procurement Continues Trend. The data center's recent procurement of the major new computer discussed above continues a trend at the TDC toward reliance on ever-larger computers. The data center remains on this course at the same time there is a national trend to smaller, less-expensive computers, maintained at a lower organizational level. This national trend is reflected in sales figures for very large mainframe computers which are reported to have fallen 32 percent since 1990. Although a recent survey conducted by a major industry newspaper indicates that large computers will remain critical for the near term, that same survey reflected a slow but steady movement of key computer applications away from large computers to smaller ones. Although the data center offers alternatives to mainframe computing, its primary efforts have been directed to obtaining more business for its mainframe services, which have been its primary source of fee revenue since the data center's inception. Yet, experts agree that mainframe computing is in a transitional phase, with many traditional mainframe users deferring the purchase of newer mainframes whenever possible.

Given this situation, it is reasonable to ask whether and when there will come a point in time when the continued long-term investment in large mainframe computers is a path the data center should veer away from.

Does the Path Lead to a More Costly Future? In attempting to justify its $5.5 million bid to the DMV for the Network 2000 project, the TDC indicated that the basic reason for such a low estimate was a determination to retain as much of the DMV's computer workload as possible, because if that workload were moved elsewhere the data center would have to reduce resources and increase rates to other clients to recover its cost of operation. (DMV fees paid the data center represent 20 percent of the data center's annual budget.) As discussed above, the data center won the DMV Network 2000 business in part by buying a large computer to increase computing capacity, and has recently proposed to enter into another contract with the DMV (which we discuss below) which we believe will accelerate the point in time when the data center will propose to acquire even more computing capacity.

If DMV becomes more dependent on the TDC for services provided by large computers, it may well constrain its ability to move its computer applications to less expensive solutions as these become available. Consequently, the mainframe computer path the data center has elected to emphasize could lead to a more costly future for the DMV. The implications of this path for the DMV can also apply to other data center clients. Consequently, the administration should assess the data center's vision, with its heavy reliance on mainframe applications, in order to determine whether that vision is in the best long-term interests of the state. Otherwise, the data center may, through non-competitive price offerings, drive its clients to choices that ultimately will be more costly.

LEGISLATIVE OVERSIGHT AND OTHER ISSUES

Legislative Intent Ignored

We recommend that the Legislature adopt Budget Bill language to ensure that the Legislature receives timely notification of major computer projects.

The 1993 Budget Act contains language (Provision 2) that requires advance notification to the Legislature before the data center may enter into a procurement agreement for future or multi-year expenditures for computer projects about which the Legislature has not been informed. This provision, also included in the 1994 Budget Bill, gives the Director of Finance authority to authorize such agreements or projects upon specified notification to the Legislature. Neither the current nor the proposed language explicitly provides for notification for procurements with major fiscal implications such as the six-month, $1.5 million lease the Director of the TDC approved, as discussed above. We believe that such notification is important in order to advise the Legislature of the costs of major procurements (over $1 million, which is consistent with the Department of Finance's current reporting requirements for TDC projects). Accordingly, we recommend that Provision 2 be modified as follows:

> The Director of the Teale Data Center shall not enter into any procurement agreement, with future or multi-year expenditures exceeding $1 million for computer projects about which the Legislature has not been specifically informed pursuant to this provision. The Director of Finance may authorize such agreement or projects to proceed no sooner than 30 days after notification in writing of the necessity therefore is provided to the chairpersons of the fiscal committees and the Chairperson of the Joint Legislative Budget Committee, or not sooner than whatever lesser time the chairperson of the joint committee, or his or her designee, may in each instance determine.

Inconsistent Cost Recovery Practices Should Be Ended

We recommend that the Legislature adopt supplemental report language requiring an independent review of the data center's billing and cost recovery practices.

As noted above, state policy requires that agencies recover the full cost of services provided others. Also discussed above, is the data center's contract with the DMV for Network 2000, under which the data center will *not* recover its cost of service provided the DMV. In addition:

- The data center has provided the DMV with services on a "flat fee" basis which does not ensure the full recovery of cost.
- The data center recently made a proposal to the DMV to perform major new work for which the data center committed to a *maximum* billing of $5 million and a cap on processing charges for one year following completion of the work. A joint proposal made by two private vendors to meet the same DMV need was reported to exceed $40 million in cost.
- The data center in 1991 began the installation of a new desktop computer network for the Business, Transportation, and Housing Agency (BTHA). According to the TDC, its cost to acquire and install the system totaled approximately $250,000. To date, the data center has recovered no more than half that cost, and it is unclear as to when it will recover the remaining balance, as the BTHA's 1994-95 budget for the data center totals only $35,000.

When the data center fails to charge properly for services rendered, its other clients make up the difference through the fees they pay.

In our view, these practices are fiscally unsound. In order to end such practices, we believe that an independent review and modification of the center's billing and cost recovery practices is needed. We believe that such a review will result in a more equitable method of cost recovery consistent with long-standing state policy.

Specifically, we recommend that the Legislature adopt the following supplemental report language:

> There shall be an independent review of the data center's billing and cost-recovery practices to: (1) identify practices inconsistent with the state's policy governing cost recovery and (2) recommend changes to bring practices in line with the policy. This review shall be conducted under the direction of the Department of Finance which will (1) recover from the data center the full cost of any contract, including the department's administrative costs, (2) direct the data center to implement those recommendations that the Department of Finance believes appropriate, and (3) provide a copy of the review to the Legislature not later than January 6, 1995.

Problems Suggest Need for Better Oversight

We recommend enactment of legislation to create a Board of Directors to oversee the operation of the data center. We further recommend that until such legislation is enacted, the Department of Finance administratively establish an interim advisory board to perform specific oversight functions.

As we have indicated earlier in this *Analysis*, the TDC is facing a number of problems which fall into three broad categories of (1) procurement, (2) fiscal management, and (3) compliance with state law and policy.

We believe that the magnitude of these problems is such that they are not likely to be resolved without outside intervention. A reasonable method to accomplish the needed intervention, without unduly compromising the ability of the data center to manage its day-to-day activities, would be through the creation of a "Board of Directors" which would have specific oversight responsibilities. These responsibilities should include, but not be limited to, the review of (1) the data center's annual budget, (2) any proposed project, contract, or inter-agency agreement which has significant fiscal implications, and (3) changes to the data center's rates.

Concept is Not New in State Service. The concept of a governing body to oversee a state data center operation is not new. The Health and Welfare Agency Data Center (HWDC) has had since its inception a Policy Advisory Committee (PAC) which currently performs functions similar to those we envision for a TDC Board of Directors. The PAC is made up of the deputy directors of administration in the HWDC's client departments. The PAC's charter provides for the review of (1) the HWDC's budget, (2) proposed new service offerings, and (3) taking on work for new clients. Several years ago, the TDC also had a fiscal advisory body, but that body subsequently became inoperative.

Analyst's Recommendation. We believe that the TDC needs help to resolve its problems. A properly constituted and charged Board of Directors could provide much of the help we believe the data center needs. Thus, we recommend enactment of legislation to create such a body. Because legislation will take some time to be enacted, and because of the center's serious problems, we further recommend that the Department of Finance administratively establish an advisory board to the OIT regarding TDC matters as soon as possible, and encourage the department to include key TDC clients on the board. The OIT, currently, has the authority to review and approve various data center activities, but has very limited staffing. Consequently, an advisory board could be of significant help to the OIT regarding those activities the OIT believes need independent review. We believe that the board could operate within existing state budgets.

Performance Budget Pilot Department

The data center's participation in the Governor's performance budget pilot program has not resulted in performance budgeting in the proposed budget.

The TDC is one of four pilot departments selected by the Department of Finance in January 1993 to participate in the administration's performance budget pilot program (please see the Crosscutting Issues section of this chapter for a full discussion of the pilot program).

Our review of the performance budget pilot program indicates that no significant progress has been made with respect to the TDC's participation in the program. Given this fact and the many significant problems that the TDC is experiencing and that warrant attention, we believe that the Department of Finance may wish to reconsider the data center's participation in the pilot program.

Technical Budget Issues

We recommend a reduction of $2.6 million due to overbudgeting (Reduce Item 2780-001-683 by $2.6 million.)

Our review of the data center's proposed budget indicates that several items have been overbudgeted and should be reduced. The specific reductions, which total $2.6 million, are as follows:

- $1.5 million in reduced revenue resulting from recent reductions in rates.
- $1 million and 11 positions that will expire at the end of the current year.
- $100,000 in unjustified legal and procurement services.

New Computer Facility Planned

We withhold recommendation on $135,000 proposed for space management services from the DGS pending more information from the data center as to its plans for a new computer facility.

The proposed budget includes $135,000 for space management services from the DGS. According to the data center, these funds are needed in part to continue planning for a new computer facility that the data center would like to have constructed by July 1997. The data center advises that it intends to *lease* the new facility; however, DGS' "1993 Statewide Facilities Plan and Asset Management Strategy" indicates that the new facility will be either *purchased* or *leased with an option to purchase*. These latter options are consistent with the Governor's Executive Order W-18-91, which encourages the state's ownership where the need for the facility is "long-term and ownership is economically advantageous over the life of the facility." The

DGS indicates that at least two potential sites for the new facility have already been identified.

The data center currently pays a relatively low lease rate in its current facility. The special requirements of the data center, which include a substantial amount of costly raised floor, chilled water supply for mainframe computers, microwave and other communications capability, a high voltage electrical feed and a diesel generator back-up capability, will result in a relatively costly new facility. The move to a new facility could result in the need to increase fees or to borrow funds to avoid a fee increase. Given this situation, the Governor's Executive Order which favors state ownership, and the concerns discussed above regarding fiscal problems in the data center, we believe that the Legislature should not approve funds to plan for a new facility until after the data center has explained its plans in more detail, including any potential impact on rates. Thus, we withhold recommendation on the data center's request.

HEALTH AND WELFARE AGENCY DATA CENTER (4130)

The Health and Welfare Agency Data Center (HWDC) provides information technology services, including computer and communications network services, to the various departments of the Health and Welfare Agency. The center also provides services to other state entities and various local jurisdictions. The cost of the center's operation is reimbursed fully by its clients.

The budget proposes $102 million from the Health and Welfare Data Center Revolving Fund for support of the center's operations in 1994-95, which is an increase of $14.2 million, or 16 percent, over estimated current-year expenditures. The increase is primarily due to major new work for the Department of Social Services (DSS).

The Statewide Automated Welfare System (SAWS) Needs Further Review

We withhold recommendation on $17.8 million proposed for services to the DSS in support of the SAWS project, pending legislative review of the revised costs and benefits of the project and the specific implementation method selected by the DSS.

The budget proposes $17.8 million and 45 positions for support of the SAWS project. These funds are contained in the budget request of the DSS and would be used to reimburse the HWDC for its cost of computer services provided for the SAWS project.

Background. The SAWS project, estimated to cost $800 million over 12 years, is the most costly application of information technology ever undertaken by the state. The purpose of the project is to provide a uniform, computer-based system for administering health and welfare programs in all counties, except Los Angeles County, which has statutory authorization to implement its own system. As planned by the DSS, SAWS will be developed using as its base an automated system currently in use by Napa County, called NAPAS. Counties would be phased-in with all counties operational on the new state system by the year 2000.

Proposal Should Conform to Action Taken in DSS Budget. In our analysis of the DSS (please see the Health and Social Services section of this *Analysis*) we discuss several major issues regarding SAWS, including the interim project at the HWDC. In that discussion we withhold recommendation on *all* funds proposed for SAWS pending a review by the Legislature of the opportunities and problems associated with this important project. Accordingly, we withhold recommendation on the $17.8 million requested to enable the HWDC to provide services for the SAWS project.

Kiosk Project Evaluation Plan Should Be Expanded

We recommend that the Legislature adopt supplemental report language directing the HWDC to expand its evaluation of the information kiosk project to include an assessment of the costs and benefits of kiosks to departments which make use of them.

The 1993 Budget Act contains $7 million for the continued implementation of the INFO/California pilot project, to demonstrate the value of computer-based kiosks to improve the delivery of various government services. Each kiosk contains a full color TV-type display screen, keyboard, the capability of reading the magnetic stripes on credit cards, and the driver license and identification cards issued by the Department of Motor Vehicles. The kiosks are linked electronically to the HWDC. Fifteen kiosks were distributed throughout the state to test their usage and gather information needed to decide whether to expand the project. Services available on the kiosks include certain driver license and vehicle-related transactions, ordering copies of birth records, and obtaining information relating to job opportunities.

Plans to Expand INFO/California. Based on the pilot project, the HWDC is in the process of awarding a $21 million contract which will enable it to acquire up to 300 additional kiosks. In addition, the contract will provide for the development of client (state departments, federal, and local governments) applications to be included in the kiosk's menu of services. Under the terms of the contract, the state will be obligated to purchase at least 104 of the kiosks within specified time frames, at a cost of approximately $5.2 million. The HWDC plans to sell kiosk service to various agencies of the state, federal and local governments in order to recover fully its cost of the kiosk program.

Costs and Benefits to Client Departments Should Be Evaluated. The 1993 Budget Bill included language intended to control the use of kiosks, including a requirement that the pilot project be formally evaluated before additional kiosks could be installed using state funds. All INFO/California-related language was vetoed by the Governor. However, in approving the proposal to acquire 300 additional kiosks, the Department of Finance is viewing the first 100 of these kiosks as a *new* pilot project, and has required that the HWDC formally evaluate this pilot before acquiring any additional kiosks. Accordingly, the HWDC has developed an evaluation plan to meet this requirement. This evaluation will focus on the cost-effectiveness of the kiosk program from the data center's perspective.

In focusing its evaluation on whether the kiosk program is cost-effective *to the data center*, the question of cost-effectiveness *to the client departments* will be unanswered. We believe this question needs to be answered, because without understanding the costs and benefits of kiosks to the state as a whole, neither the administration nor the Legislature will have sufficient information upon which to consider the substantial deployment of kiosks that the administration has suggested, a deployment which could easily exceed by a wide margin the 300 planned in the current procurement. For that reason, we recommend that the Legislature adopt supplemental report language directing that the HWDC evaluation be expanded to address the costs and benefits of the kiosk program to the state agencies which participate in the new pilot project. Specifically, we recommend the following language:

> The data center shall expand its evaluation of the INFO/California program to include an evaluation of the costs and benefits of the program to the state agencies which participate in the new pilot project, and report its evaluation to the Joint Legislative Budget Committee and the Legislature's fiscal committees at the same time it reports the evaluation to the Department of Finance.

OFFICE OF EMERGENCY SERVICES (0690)

The Office of Emergency Services (OES) coordinates emergency activities necessary to save lives and reduce losses from disasters. The OES further acts as the state's conduit for federal assistance related to recovery from disasters.

The amount proposed for direct support of the OES in 1994-95 totals $35.7 million, including $17.9 million from the General Fund, $12.9 million from federal funds, and the remainder ($4.9 million) from various other funds and reimbursements. The proposed direct support is approximately $1 million, or 2.9 percent, less than estimated current-year expenditures.

In addition to direct support costs, the budget includes $165 million for local assistance to pay claims from previous disasters. This is $26.8 million, or 14 percent less than estimated current-year expenditures for local assistance as reflected in the Governor's Budget proposal. The amount proposed for local assistance in the budget year includes $135 million from federal funds, $15.5 million from disaster assistance accounts, $12.6 million from the General Fund, and $1.7 million from the Nuclear Planning Assessment Special Account.

Proposed Budget Should Be Viewed as Fluid

The amounts proposed for support and local assistance should be viewed as somewhat fluid, given the recent Northridge earthquake and historical differences between budgeted and subsequent actual expenditures. For example, since 1990-91, the difference in expenditures for state support varied by as much as 23 percent between budgeted expenditures and subsequent actual costs. Similar differences exist in local assistance expenditures. These variations are primarily the result of the unbudgeted costs of major disasters. Consequently, the amounts proposed in the budget for state support and local assistance need to be viewed in that context.

Improving the Reporting of Disaster-Related Information

We recommend that the Legislature adopt supplemental report language directing the OES to develop a specific plan to implement a computer-based information system which will better meet the needs of the Legislature and the administration for information relating to disasters.

There are three fundamental kinds of information that the Legislature typically needs to know with respect to disasters:

- Status reports which indicate the location and extent of damage, and the response to the emergency. This kind of information is wanted immediately following a disaster.
- Reports as to actual and projected expenditures regarding disasters in both an aggregated and specific disaster form.
- A description of the various forms of assistance available to disaster victims.

Information Needs Not Being Met Well. In previous *Analyses*, we have pointed out the lack of timely, complete, and relatively accurate information regarding disasters. This situation not only makes it difficult for the Legislature to have a reasonably clear picture of actual and projected disaster-related expenditures, but is particularly troublesome during the period immediately following a major disaster when the demand for information from the Legislature, other state decision-makers, and the news media is high.

The deficiencies of the state's disaster information system were highlighted following the recent Northridge earthquake. Despite the best efforts and responsiveness of OES staff, not only was it difficult to obtain comprehensive information regarding the immediate earthquake, it was also difficult to obtain updated information on previous disasters. As a consequence, there tends to be a flurry of staff activity in both the legislative and executive branches to develop needed information, which is seldom developed quickly enough to satisfy the needs of the state's decision-makers. Moreover, the rush to develop information on an accelerated schedule always carries with it the risk that the information will contain inaccuracies or be incomplete.

Legislative Efforts to Improve Information Delivery Are So Far Unsuccessful. Last year, the Legislature adopted supplemental report language requiring the OES to provide quarterly reports to the Legislature regarding expenditures and transfers related to disaster assistance costs. The first report was due October 1, 1993. To date, the OES has not submitted any quarterly reports. It is not clear as to why the OES has not complied with the reporting requirement.

Administration Needs a System for Collecting and Distributing Disaster-Related Information. We believe that a major part of the OES' difficulty in providing needed information is that there is no adequate *system* within the administration to collect, maintain, and make available to others information relating to disasters. The OES is not the only state agency involved in disaster assistance. Consequently, even if the OES had a system for collecting and reporting on expenditures it makes, the information would be incomplete because it would not include expenditures made by other agencies (such as grants made by the Department of Social Services, repairs made by Caltrans, and loans made by the Department of Housing and Community Development).

The Need for a Better System Is Apparent. It is apparent that a better system for collecting, maintaining, and disseminating information related to disasters is needed, and we believe that the use of computers can make a better system possible. For example, the current OES method of disseminating disaster-related information rapidly is via facsimile transmission (FAX). While this method eventually gets needed information out, it requires the OES to allocate staff resources (which are scarce during an emergency) to preparing and disseminating disaster status reports to the many individuals and organizations asking for the reports. Clearly, given the extent of computer networks available and in use by many of those requesting the status reports, the OES would significantly improve its responsiveness to information needs by coordinating its efforts with other affected departments and establishing and maintaining status reports on a computer file accessible directly to anyone needing the information. Similarly, a computer system could be established for the collection, maintenance, and dissemination of information relating to the costs of disasters, past and present.

State Computer Networks May Help. The use of existing state computer communications networks offers one way to ensure the continued delivery of information soon after a disaster, as these networks tend to remain available because of alternative paths designed to avoid service disruptions. Both the Health and Welfare Agency Data Center and the Stephen P. Teale Data Center maintain such networks. The use of these networks may be useful for additional purposes as well, such as transmitting electronic messages throughout the state. This possibility exists because each of the data center's computer networks embraces thousands of computer terminals and personal computers located in various of the state's field offices (for example, those maintained at Employment Development Department offices), and these devices could be made available to disaster workers during an emergency.

OES Should Plan for Changes Now. Given the rate of disasters in California, and the burden this places on the OES staff to coordinate the emergency response, it is virtually impossible to ever find the “right” time to focus on making improvements in the gathering of information relating to disasters. Consequently, it is important for the OES to initiate improvements now. For that reason, and because the OES has not been responsive to the Legislature's current request for better information last year, we recommend that the Legislature adopt the following supplemental report language:

> The Office of Emergency Services (OES), in cooperation with other affected state agencies, shall prepare and submit to the Legislature, by December 30, 1994, a plan to meet the needs of the Legislature and others regarding information relating to disasters. In preparing this plan, the OES shall consult with Members of the Legislature, their staffs, other state decision-makers, and representatives of the news media to confirm the information needs to be

reflected in the plan. The plan shall provide for a computer-based system which will (1) provide for the OES to collect disaster-related expenditure information from other state agencies so as to provide a comprehensive database of information, and (2) enable the direct, electronic access of disaster situation reports which are currently made available via facsimile transmission. The plan shall address the feasibility of using one or more of the state's existing data center networks to support emergency communications, and shall be in the form of a Feasibility Study Report for an information technology project as prescribed in the State Administrative Manual.

Information Regarding Assistance Programs

We recommend that the Legislature adopt supplemental report language directing the OES to evaluate methods for improving the distribution of information relating to disaster assistance programs, and to report findings, recommendations, and plans to the Legislature by December 30, 1994.

As indicated above, Members of the Legislature also want to be informed as to the various forms of assistance available to victims of disasters. And, no one is more interested in such information than the victims themselves. We believe that the OES can improve the distribution of such information by, for example, setting up computer-based kiosks in disaster areas. At the simplest level, kiosks could be used to simply display information; or, they could be used at a level which would allow linkage to a central computer to transmit and receive information (for example, actually applying for assistance).

To keep legislators and others apprised of the various types of assistance programs, the OES could also develop and maintain a simple handbook, which could be made available to anyone upon request (for example, the news media), or the OES could establish the information so that is was available via a computer network.

For these reasons, we recommend that the Legislature adopt the following supplemental report language:

> The Office of Emergency Services shall evaluate methods to improve the availability and dissemination of disaster assistance information and report to the Legislature, by December 30, 1994, as to its findings and recommendations, and plans for improvement. The evaluation shall consider, but not be limited to: (1) the use of computer-based kiosks and (2) handbooks.

BOARD OF CONTROL (8700)

The Board of Control (BOC) oversees diverse activities including state regulation and management of claims under the following programs: Citizen Indemnification (also known as the Victims of Crime Program), Civil Claims Against the State, and Hazardous Substance Claims. The Victims of Crime (VOC) Program accounts for about 99 percent of the board's total expenditures.

The budget proposes expenditures of $104 million in 1994-95, including $860,000 from the General Fund. This is $13.9 million less than current-year estimates. The difference is, in part, the result of a General Fund augmentation for 1993-94 to eliminate a backlog of approved claims for the VOC program.

Shortfalls Continue in the Victims of Crime Program

We recommend that the board report during budget hearings on the status of the funding of the VOC program. Specifically, the board should report on: (1) the status of funding for the current-year, (2) the status of legislation to modify the distribution of revenues to the Restitution Fund, (3) the impact of the proposed legislation, if enacted, on future program funding needs, and (4) the board's proposed actions for continuing to reduce program and administrative costs.

The budget proposes $104 million in expenditures for the VOC Program. The board projects that it will pay $76 million in claims in 1994-95. Administration of the program will cost $28 million. Resources to support the program are from the Restitution Fund ($89 million) and federal funds ($15 million).

Background. The VOC Program compensates those persons who (1) are injured and suffer financial hardship as a result of crimes of violence, (2) suffer financial hardship because a family member was injured as a result of crimes of violence, or (3) sustain damage or injury while performing acts that benefit the public. About 80 percent of the cost of claims is for noninsured medical and mental health expenses. The remaining costs are for wage loss, funeral expenses, and rehabilitation expenses.

The program is primarily funded by appropriations from the Restitution Fund and federal funds. The Restitution Fund receives its revenues from restitution fines and penalty assessments imposed on persons who violate criminal or traffic laws.

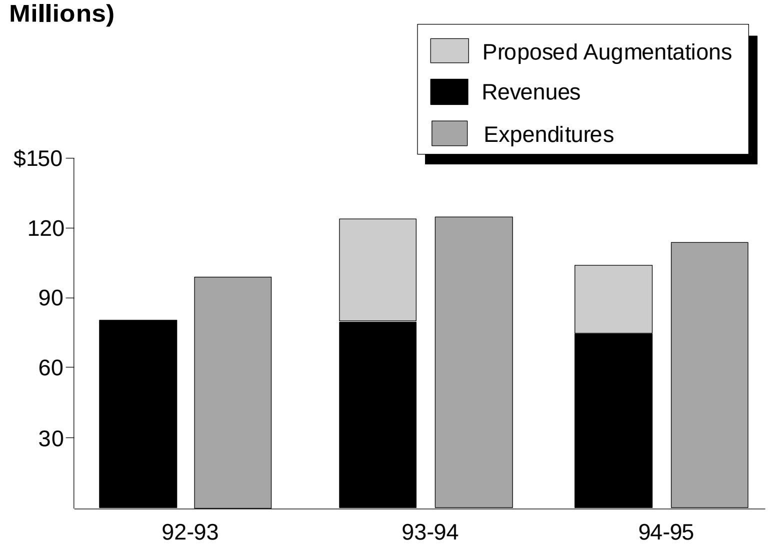
Increasing Costs Have Exceeded Revenues. The VOC Program has grown dramatically in recent years. Between 1988-89 and 1992-93 the number of

VOC claims grew 85 percent, causing a depletion of the Restitution Fund's reserves. Figure 24 shows expenditures and funds (both Restitution Fund and federal funds) to support the program during the past, current, and budget years.

Figure 24

Expenditures in the Victims of Crime Program Exceed Resources

(In Millions)



The board experienced its first deficit in 1992-93, totaling $18.4 million. The board used $6 million in reserves to cover part of the deficit and postponed paying $13 million in approved claims until the current year. The board estimates that, by carrying over these claims into the current year, it will not be able to pay all new claims creating a shortfall of $32.4 million in 1993-94. The story is the same in 1994-95: the board will be unable to pay all claims resulting in a shortfall of $34.5 million in that year.

Program Costs Not Tied to Revenues. The basic problem with the funding of this program is that there is no direct relationship between program revenues and program expenditures. Specifically, revenues are tied to a statutory formula and not an evaluation of program funding needs. Therefore, as claims grow, revenues are not designed to keep pace. Since 1988-89, claims for all covered crimes have increased except for “hit and run” cases. For example, paid claims for child molestation crimes grew from $15 million in 1988-89 to over $25 million in 1992-93, a 67 percent increase. In that same time frame, resources to support the program increased only 29 percent.

Program Has High Administrative Costs. In addition to increasing program costs, the board's administrative costs are substantial, contributing to program shortfalls. According to a recent management study of the VOC Program, the board spends $1.00 in total administrative costs for every $3.65 in claims payments (nearly 22 percent of total expenditures). The relatively high administrative costs result because board staff must determine applicant eligibility, which requires detailed examinations of evidence that a crime has occurred, that the applicant cooperated with law enforcement officials, and that the victim did not contribute to the crime. Further, the board must determine the appropriate amount to pay. Since the VOC Program is a "payer of last resort," the board must determine if there is any other funding source, such as insurance, and whether the cost is covered under the program, before determining how much of the claim to pay. The board increases its administrative burden because it allows applicants, who are often victims of a serious crime, a great deal of flexibility in the review of their claims. For example, the management study noted that the board frequently accepts incomplete claims and works with the victim to acquire the information, which adds to the amount of time necessary to process claims.

Actions Have Been Taken to Reduce Program Costs and Increase Revenues. Since 1992, the board has taken a variety of actions to reduce program and administrative costs, and to increase revenues. The board has adopted the State's Workers Compensation Fee Schedule as the maximum rate of reimbursement for injury claims and projects that this will save $3 to $5 million per year. The board also has begun discounting in-patient hospital bills by 25 percent. The board advises that providers are willing to accept the reduced reimbursements in exchange for prompt payment of their claims. The board estimates that this discounting will save an additional $5 to $8 million per year. The board also expects to realize annual savings of $4 million by reviewing and pre-approving certain types of therapy programs. Finally, the board has implemented a variety of new processes for reviewing claims that it believes has increased efficiency 10 percent.

Furthermore, the Legislature enacted Ch 682/92 (SB 1444, Presley) which provided an additional $5 million annually in revenue to the Restitution Fund. In addition, Chapter 780, Statutes of 1993 (SB 644, Presley), which allowed the board to limit the amount of benefits paid for long-term income loss or loss of support payments, and for mental health payments, is estimated to save up to $6 million in 1994-95.

Despite the efforts to reduce expenditures and increase revenues into the program, shortfalls remain.

Administration's Proposals to Address the Shortfall. The Governor's Budget proposed a $44 million General Fund augmentation in the current year in order to eliminate the projected deficit and fund the program's backlog of approved claims for the current year. In late January 1994, the

Legislature enacted Ch 4/94 (AB 2386, Vasconcellos), which appropriated the $44 million.

For 1994-95, the Governor's Budget proposes to modify the distribution formula of penalty assessment revenues, which will increase revenues to the Restitution Fund by $29.3 million. Specifically, the budget indicates that the administration will propose legislation to reduce the share of penalty assessment revenues that is deposited into the Driver's Training Fund, and redirect those revenues to the Restitution Fund for support of the VOC Program, and to the Victim/Witness Assistance Fund for support of programs in the Office of Criminal Justice Planning (OCJP).

In recent years, the bulk of revenues in the Driver's Training Fund has been transferred to the General Fund. Thus, the budget proposal will result in a loss of revenue that might otherwise have been transferred to the General Fund. We discuss the administration's proposal with respect to penalty assessments in greater detail in the Judiciary and Criminal Justice Section of this *Analysis*.

The Administration's Proposal Will Reduce, But Not Eliminate Shortfalls in 1994-95 and Future Years. Our review indicates that, even with the redirection of Driver Training Fund revenues, the board will have a deficit of up to $8 million in 1994-95. For 1995-96, we estimate the expenditures will also exceed revenues by at least $3 million, resulting in continuing funding shortfalls.

The Legislature has several options for both reducing program costs and increasing revenues to support the program, as discussed below. We believe that some mix of these options could help alleviate future shortfalls.

Cost Containment Options. In addition to the program changes that have already been implemented, the following cost containment options would also help reduce program costs:

- Limit the number of counseling sessions for victims. According to the board's recent management study, there are specific therapeutic guidelines for the minimum and maximum number of sessions necessary for treatment of molestation victims and their families. Currently, the board limits these benefits only to a dollar value. Adoption of these guidelines could reduce costs and allow the board to approve claims based on simpler, more objective criteria.

- Limit program benefits to primary victims only, thereby eliminating coverage of family members. Chapter 780 provided that victims can receive up to $10,000 in mental health benefits and “derivative victims” (which includes family members) can receive up to $3,000. Although we recognize the needs of the families of victims, the primary focus of the program should be on the victims themselves. If resources to support the program are insufficient, the claims of *victims* should have first priority. Limiting benefits to primary victims would result in savings of $10 million to $15 million annually.

- Eliminate coverage for victims of hit-and-run accidents who are driving without the required insurance. State law requires that drivers be insured. Therefore, it is questionable whether the state should provide benefits for persons out of compliance with state law (savings of $6 million to $7 million annually).

- Pay claims for only two to three years. Currently, there is no limit on the length of time that benefits can be provided to victims. Although victims may need services (especially counseling) for a long period, given tight fiscal constraints, a limit on the filing period for a claim for benefits is not unreasonable (unknown annual savings).

- Reduce administrative cost of processing claims. This could be accomplished in a number of ways, such as better use of automation, revising and streamlining the review process, and limiting duplicative claim reviews (unknown annual savings).

Revenue Enhancement Options. As a means of further increasing revenues to the Restitution Fund, the Legislature could also consider increasing revenues to the program through mechanisms that require offenders to pay for their victimizations. Such options include the following:

- Impose a new restitution fine for misdemeanor offenses at a minimum of $100 (annual revenues of $4 million to $5 million).

- Increase the share of fine revenues allocated to the Restitution Fund from $20 to $50 for driving under the influence (DUI) offenses (annual revenue of $4 million to $5 million).

Analyst's Recommendation. Because of the magnitude of the current funding shortfall in the VOC Program, we recommend that the board report during budget hearings on the status of the VOC Program. Specifically, the board should provide (1) the status of the funding for the current year, (2) an update on the status of legislation modifying the formula for allocation of the Penalty Assessment Fund, (3) an estimate of the effect of the proposed revenue redistribution on future program funding needs, and (4) the revenue enhancement and cost containment changes being considered by the board to reduce or eliminate current and future funding shortfalls.

Confusion Over Payment of Claims for the Costs of Special Elections

We recommend that the board report during budget hearings on the implementation of Ch 39/93 (AB 37, Johnson) which requires that counties be reimbursed for the costs of special elections. We further recommend that verified claims be placed in the annual claims bill.

Background. Chapter 39, Statutes of 1993 (AB 37, Johnson), requires the state to reimburse counties for all expenses incurred as a result of conducting special elections held after January 1, 1993, to fill a vacant seat in the Legislature or Congress. Previously, counties were responsible for the costs of all elections, even special elections to fill vacancies. While the measure authorized reimbursement for the costs of these elections, it did not specify a method for reimbursement nor did it include an appropriation.

Confusion Over Responsibility for Claims. Since the enactment of Ch 39/93, six counties have filed 14 claims with the board's Government Claims Division for reimbursement of $1.3 million in special election expenses.

According to the board, none of the claims have been processed because the legislation did not specify a procedure for the payment of the claims. The board advises that it is not processing the claims until after the Commission on State Mandates has reviewed the claims.

Although it is common for the commission to review local government claims, our review and a Legislative Counsel opinion indicate that the board has the authority to examine and approve the claims on its own for payment using its general process for reviewing all governmental claims. This procedure allows for a review and examination of the validity of the claims. When the board approves a claim, funds are requested to pay the claim in the omnibus claims bill that comes before the Legislature.

Analyst's Recommendation. Given the significant number of special elections already held and likely to occur in the future, the costs will likely be much higher than the $1.3 million in claims already submitted. Because of the confusion surrounding the processing of the claims and the potential costs, we recommend that the board report during budget hearings on: (1) the status of claims that the board has received and (2) the process it has established to process these claims. We recommend further that verified claims be placed in the annual claims bill.

DEPARTMENT OF VETERANS AFFAIRS (1960) AND VETERANS' HOME OF CALIFORNIA (1970)

The Department of Veterans Affairs (DVA) provides services to California veterans and their dependents, and to eligible members of the California National Guard. The principal activities of the DVA include: (1) providing low-interest home and farm loans to qualifying veterans, using proceeds from the sale of general obligation and revenue bonds; (2) assisting eligible veterans and their dependents in obtaining federal and state benefits by providing claims representation, county subventions, and direct educational assistance to qualifying dependents; and (3) operating the California Veterans' Home in Yountville, which provides approximately 1,125 California veterans with several levels of medical care, rehabilitation services, and residential services.

The budget proposes total expenditures of $402 million for the DVA in 1994-95. This is $18 million, or 4.3 percent, less than current-year expenditures. Expenditures from the General Fund total $28.2 million in the budget year, an increase of $1.9 million, or 7.2 percent, over total General Fund expenditures in 1993-94. The primary reason for the reduction is due to a decrease in the amount of scheduled debt service the department must pay in the budget year for the Cal-Vet Home Loan Program.

Significant Cost But Lack of Demand For Veterans Homes

We withhold recommendation on $840,000 and ten positions for the new veterans home in Barstow, pending a report during budget hearings on the demand for additional capacity at this home and the veterans home in Yountville. We further recommend the enactment of legislation to eliminate the statutory authority for the department to construct any additional veterans homes.

The budget requests $840,000 from the General Fund and ten new positions to establish a "pre-activation" team for the proposed new Southern California veterans home in Barstow (San Bernardino County). The new home will be designed to house and provide services to up to 400 veterans from Southern California. Although the new home is not scheduled to open until January 1996, the department is requesting these positions in 1994-95 to plan for the activation of the home.

Background. Under current law, the department is authorized to build new veterans homes in Southern California in multiple locations. The department's justification for the construction of these new homes is based on various studies that found that by the year 2000, over 600,000 veterans over the age of 60 years will be living in one of seven Southern California counties. Under this authority, the department plans to build a total of four new homes, each designed to house and provide services to up to 400 veterans. The first phase of this multi-phase project is to build the Barstow home in 1994-95. At this time, there is no construction schedule for the three additional homes the department plans to build.

The department estimates that the total cost to complete the Barstow home will be approximately $31.8 million. The U.S. Department of Veterans Affairs (USDVA) will fund $19.8 million of these costs and the state's share of remaining project costs will be financed with $11 million in lease-payment bonds. (The state provided $1 million in planning funds, from the Special Account for Capital Outlay, in the 1988 Budget Act.)

Once the Barstow home is fully operational, the department will have to hire approximately 265 staff positions for support of the facility. The department estimates that the *annual* operating costs for the salaries and wages for these positions will be approximately $8.5 million. In addition, other operating expenses, including the debt service payments required to pay off the lease-payment bonds, will bring the total annual costs of the Barstow home to approximately $11 million. At this time, the department is projecting that the annual General Fund support for this home will be approximately $5.4 million. The remaining operating costs will come from the USDVA per diem subsidy, Medicare/Medi-Cal payments, third party insurance payers, and reimbursements from member fees.

1993 Legislative Concerns About Expansion of New Homes. Last year, the Legislature expressed concerns about the costs and need for the additional veterans homes. Because of these concerns, the Legislature adopted budget control language in the 1993 Budget Bill directing the department to delay the construction of the new veterans home until the Department of Finance and the Joint Legislative Budget Committee could certify that the state had adequate General Fund resources to support both the operating costs of the home and the debt service cost for the lease revenue bonds authorized for the construction of the home. The Governor, however, vetoed this Budget Bill language. According to the Governor's veto message, the delay in constructing this facility would cause the state to lose a $20 million federal grant for the construction of the facility. On January 24, 1994, the department awarded the construction contract for this facility.

Concerns Regarding New Home Remain Valid. Our review indicates that the concerns the Legislature expressed last year remain valid for several reasons:

- ***No Waiting List for the Proposed or Existing Home.*** Although the department has received a few phone calls from veterans inquiring about the new Barstow home, the department has *no waiting list* of veterans requesting residency at either the new Barstow or the existing home in Yountville. Despite the increasing number of aging veterans, there is reason to believe that demand at the veterans homes will not increase significantly. This is because these veterans have significantly more retirement options than previous veterans.

- ***Current and Future Excess Capacity at Yountville Home.*** Although the department estimates that it will provide housing and services to 1,125 veterans during the budget year at Yountville, the home actually could provide services to 125 additional veterans. Since there currently is no demand from California veterans for these beds, the beds remain empty. In addition, the department has reduced its capacity at the Yountville home while it completes a major remodeling project. When this project is completed, the Yountville home will be able to provide housing and services to 1,673 veterans. This is 548 more veterans than the estimated population for the current or budget year. The department expects to complete the renovation of all beds by 1997.
- ***Significant Increase in General Fund Costs.*** When the department completes the Yountville remodeling project, the construction of the Barstow home, and the construction of the three other Southern California veterans homes, the additional annual General Fund operating cost for veterans homes could increase by as much as $24 million (in current dollars).

Actions the Legislature Can Take Given Excess Capacity. Given the excess capacity in the veterans homes, there are a number of actions the Legislature could take to limit the state's General Fund costs in the budget year and future years:

- ***Only Partially Activate the Barstow Home.*** The Legislature could request the department to only partially activate the facility until it demonstrates that there is sufficient demand and funding to operate the facility (because the facility is financed by lease-payment bonds, at least partial activation is required).
- ***Delete Statutory Authority to Develop Any Additional Homes Besides Barstow.*** The Legislature could amend state law to delete the department's statutory authority to build any additional veterans homes in Southern California beyond the Barstow home.
- ***Deny Any Increased Funding for Additional Capacity at the Yountville Home.*** Given the excess design capacity of the Yountville home, the Legislature could stop any additional funding to increase capacity there, and partially close part of the facility.
- ***Increase Member Fees to Offset General Fund Support Costs.*** The Legislature could allow the department to proceed with the construction of the new facilities but require that the department

establish a member fee schedule that would offset the need for General Fund support (we discuss member fees in greater detail below).

Analyst's Recommendation. Given the concerns discussed above, we withhold recommendation on the ten positions pending a report from the department during budget hearings on the demand for additional capacity at the Barstow and Yountville homes. The department should also report on the total annual operational costs for each proposed new home, and provide the Legislature with an estimate of what the additional operating cost for the home in Yountville will be once the renovation project is completed. We further recommend the enactment of legislation to eliminate all statutory authority for the department to build additional veterans homes beyond the one planned for Barstow.

Member Fee Structure Needs Improvement

We recommend that the Legislature amend proposed Budget Bill language so the department may fully and better maximize its reimbursements from member fees. We also recommend that the Legislature amend state law to parallel the Budget Bill language. Finally, we recommend that the department and the Bureau of State Audits (BSA) report to the Legislature during budget hearings on the findings and recommendations that the BSA may have based on its review of the department's attempts to maximize reimbursements.

Background. Under current law, the department may charge fees to residents (or "members") at the Veterans' Home in Yountville. Fee revenues are shown in the Governor's Budget as reimbursements, which offset the General Fund costs of operating the home. State law provides that the total fees collected by the department may not exceed 30 percent of the state's annual General Fund support costs for the home. In the current year, the department estimates that it will collect approximately $6.9 million in member fees, which is equivalent to 29 percent of the General Fund support for the home.

The Legislature adopted Budget Bill language in the 1993 Budget Act that raised the cap on total fee collections to 40 percent of the General Fund appropriation for the home, and authorized the department to charge individual members a fee of up to 70 percent of their incomes. The 1994 Budget Bill proposes to continue the same 40 percent cap in 1994-95.

Department Establishes Graduated Fee Structure Based on Level of Care. In order to implement the 1993 Budget Act provision, the department developed a graduated member fee plan that became effective February 1, 1994. The department estimates that adoption of this new fee structure could generate annually an additional $1.4 million in member fees.

Under this new structure, the department assesses members fees based on (1) the level of care they receive and (2) their ability to pay. Members who receive domiciliary and residential level of care pay 55 percent of their incomes up to a maximum of $1,200 per month, while members at the intermediate level of care pay 65 percent of their incomes up to a maximum of $2,300 per month. Members who receive intensive medical services at the skilled nursing and acute levels of care, which are extremely costly, pay 70 percent of their incomes up to a maximum of $2,500 a month.

According to the department, the new fee structure will not have a significant financial impact on members. This is because the policy ensures that members still have sufficient spending money after they pay for their fees. Based on actual income data gathered by the department, very few members pay the maximum fee at any of the given levels of care, because most members have monthly incomes that are below the maximum rates the department charges.

Further Modifications Needed to Fee Policy. Although we find the department's new fee policy to be an improvement over the previous one, our analysis indicates that the new fee policy should contain additional elements. We believe that the department's approach of charging fees *based on level of care received* is reasonable because it attempts to establish a relationship between ability to pay and actual benefits received. However, we recommend that the department include the following elements into its fee structure to further ensure that those residents who can more fully pay for the services provided, do so.

First, we see no rationale for the individual fee limitations (for example, 55 percent of income up to a maximum of $1,200 per month for domiciliary care). Although we recognize that most members do not enjoy large incomes or savings, we know of no reason that the state should subsidize residency and care for the small number of members *who may have the ability to pay* for all or a higher portion of their care. Thus, we suggest that a fee structure be enacted that permits the department to charge members up to the total cost of their care.

Second, in order to ensure that members are able to have sufficient monthly spending money for personal expenses, *a fixed income exemption level,* as determined by the department, should be established.

Third, our analysis indicates that capping the amount of fees the department may collect at a fixed percentage of the *total General Fund costs* of operating the home, has no analytical basis and may prevent the department from fully recovering fee revenues. Thus, we believe that the proposed 40 percent cap in the Budget Bill—as well as the 30 percent statutory cap—should be deleted.

Review of Department's Attempts to Maximize Reimbursements in Progress. The 1993 Budget Act also required the Bureau of State Audits (BSA) to conduct a review of the department's attempts to maximize reimbursements, which would include federal reimbursements, member fees, and third-party reimbursements. The BSA began its review in December 1993 and estimates that it will complete its report and submit it to the Joint Legislative Budget Committee sometime in April 1994. The final report may provide recommendations for the department to increase its reimbursements, thereby reducing the need for General Fund support.

Analyst's Recommendation. We recommend that the Legislature amend the Budget Bill language to provide for a fee policy based on a member's ability to pay. Specifically, we recommend the following change to Item 1970-011-001, provision 3:

> Notwithstanding Section 1012.3 of the Military and Veterans Code or any other provision of law, the Department of Veterans Affairs may increase the fees and charges of residents of the Veterans' Home of California. *The department shall assess the fees on an ability-to-pay basis and* under no circumstances shall the fees charged exceed *the cost of the level of care provided to the member. In addition, the department shall determine a reasonable level of monthly income for residents personal use and shall exempt this income from the monthly fees.*

Adoption of this language may potentially allow the department to collect even a greater amount of member fees. In addition, we recommend that the Legislature amend state law to permanently establish this policy. Finally, we recommend that the department and the BSA report during budget hearings on final BSA findings and recommendations regarding the department's attempts to maximize reimbursements.

LIST OF FINDINGS AND RECOMMENDATIONS

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Crosscutting Issues

Overview of Employee Compensation Issues

1. **Ten Percent Reduction in Manager and Supervisor Positions.** We recommend that the Department of Personnel Administration (DPA) and the Department of Finance (DOF) provide to the fiscal committees the administration's department–by–department implementation plans for reducing manager/supervisor positions in advance of May Revision letters. H-14

2. **Pay-for-Performance Policy for Managers.** We recommend that prior to budget hearings the DPA and the DOF address concerns about the pay-for-performance policy for state managers. These concerns include (1) possible infringement on the Legislature's appropriation authority, (2) issues of basic fairness toward managers in state service, and (3) issues raised in a related lawsuit against the state. H-15

Tax Agency Consolidation—Information Systems

3. **Consolidation of Tax Agency Information Systems.** In order to improve state tax information, we recommend that the Legislature direct the state's tax agencies to develop a plan for integrating information systems. H-19

Performance Budgeting Offers Promise, But Off to Slow Start

4. **Pilot Program Is Behind Schedule.** The project has been slow to start and has delivered little in the way of visible evidence of performance budgeting. H-22

5. **Implementation Costs Unquantified.** There will be significant, ongoing costs to implement performance budgeting, but the administration has not identified the costs to the Legislature. H-24

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6. **Better Definition Needed.** Recommend the Department of Finance provide the Legislature more detailed information regarding its plans to implement performance budgeting. H-24

Revenue Bond Financing Authorities and Special Advisory Bodies

7. **Better Information Needed.** Withhold recommendation on $687,000 and 16 positions to fund the new California Revenue Bond Financing Authority, pending receipt of information from the administration with which the Legislature could evaluate the proposal. H-27

Augmentation for Employee Compensation

8. **Budget Does Not Provide Necessary Funds for Employee Pay Increase**. The budget does not provide the amounts needed to fully fund employee COLA pay increases. In addition, our review identifies other problems with the administration's approach to employee pay increases in the current year and budget year. H-29

9. **Options for the Legislature Regarding Employee Pay Increases**. The Legislature has four basic options in approaching employee pay increases in 1994-95: (1) approve as budgeted, (2) fully fund the pay increases, (3) require all departments to absorb the pay increases, and (4) cancel or reduce the size of the pay increase. Given the state's current fiscal situation, and the consequent pressures on the provision of program services to the public, we believe the last of these options is the most appropriate. H-32

Contributions to the Judges' Retirement Fund

10. **Create a New Retirement Plan for New Judges.** We recommend enactment of legislation to establish a new retirement program for judges taking office in the future, on an actuarially sound basis, in order to reduce long-run state costs for judges' retirement. The legislation should incorporate the retirement plan developed by the Select Committee on Judicial Retirement, with modifications to further reduce state costs. (General Fund savings totaling $4.2 million in 1994-95, and increasing annual amounts thereafter.) H-36

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11. **Increase Contribution Rates for Current Judges.** We recommend the enactment of legislation to increase the contribution rate for current judges in the Judges' Retirement System from 8 percent to 11 percent. (General Fund savings of $2.3 million in 1994-95, and $4.7 million annually thereafter.)	H-42

Public Employees' Retirement System

12. **Savings from Deferral of General Fund Contribution Appear Overstated.** The $488.5 million savings credited in the budget to the General Fund for deferral of 1992-93 contributions appears to be overstated by $44.2 million. Accordingly, we recommend that the PERS and the State Controller's Office report, prior to budget hearings, on General Fund contributions based on salaries payable in 1992-93 and the current year. The Department of Finance and the Controller's Office should reconcile these amounts with the savings shown in the budget.	H-46
13. **Overview of the PERS Budget.** The Budget Bill does not include items of appropriation for the PERS (other than one item for health benefits administration) because under Proposition 162 the PERS has authority to spend funds without appropriations by the Legislature. Since release of the budget, the PERS has increased its spending proposal by over $13 million.	H-47
14. **PERS Not in Full Compliance with Budget Act Language.** We recommend that the PERS board advise the Legislature (1) why it did not comply with the 1993 Budget Act provision regarding current-year budget revisions and (2) what steps will be taken to assure compliance with the same provision proposed in the 1994-95 Budget Bill.	H-49
15. **Investment Advisor Spending.** PERS' spending for outside investment advisors in 1994-95 is proposed at more than $77 million—an amount that equals spending on PERS' 951-person staff operations. We recommend that the PERS, prior to budget hearings, justify the proposed spending levels to the fiscal committees on a cost-benefit basis. We further recommend that the PERS provide an accounting and explanation for the changed current-year estimate, as required by language in the 1993 Budget Act.	H-50

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16. **CSU Should Not Be Exempt From Retirement-Related Savings Measures Required Elsewhere in State Government.** We recommend that the Legislature enact legislation conforming California State University post-retirement benefits to those provided for other state employees (potential General Fund savings in the range of $1 million in 1994-95, with eventual annual savings exceeding $35 million). H-52

Control Section 3.60—PERS Employer Contribution Rates

17. **Final Rates Not Yet Known.** We withhold recommendation on employer contribution rates for retirement benefits pending final determination of the actual rates to be applied in the budget year and receipt and review of information regarding the basis for the actuarial assumptions underlying the determined rates. H-56

State Teachers' Retirement System

18. **State Contribution to Teachers' Retirement is Rapidly Increasing.** State General fund contributions to the State Teachers' Retirement System are proposed to total $876 million in the budget year— $60 million more than in the current year. H-58

19. **State Costs for Supplemental Benefit Could Be Reduced in 1994-95.** In considering ways to save General Fund monies in 1994-95, the Legislature has the option of suspending or reducing supplemental benefits for maintaining purchasing power, which are non-vested benefits. For example, approximately $75 million could be saved if the benefit payments for 1994-95 were set at maintaining allowances at 60 percent of their original purchasing power instead of the current target of 68.2 percent. H-60

20. **Spending for Outside Investment Advisors Exceeds Operating Costs.** STRS' spending for outside investment advisors in 1994-95 is proposed at $52.6 million—a 113 percent increase from 1992-93 and an amount that exceeds spending on STRS' 440-person staff operations by a margin of three to two. We recommend that the STRS, prior H-61

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to budget hearings, justify the proposed spending levels to the fiscal committees on a cost-benefit basis. Pending review of that information, we withhold recommendation on $661,000 requested for additional staff to oversee and monitor investment advisors.

Health and Dental Benefits for Annuitants (9650)

21. **Budget-Year Needs Are Uncertain.** We withhold recommendation on the $329.1 million General Fund request for Health and Dental Benefits for Annuitants pending final determination of premium rates. H-64

22. **Current-Year Expenditures Are Overstated By $21.5 Million.** The estimated current-year expenditures in the Governor's Budget are overstated. Consequently, the Legislature can expect additional General Fund resources for 1994-95 of approximately $21.5 million. H-64

Control Section 4.00—
Health Insurance Premiums

23. **Health Insurance Premium Rates for 1994-95 Have Not Been Determined.** We withhold recommendation on the monthly state contribution rates for annuitant health insurance specified in this section, pending final determination of the health insurance premiums to be charged in the budget year. H-67

24. **CSU Health Insurance Premiums.** We recommend that the Legislature not exempt the CSU from Control Section 4.00. H-68

Board Of Equalization

25. **Board Should Hire Consultant to Manage Data Processing Project.** Recommend that board hire consultant with proven experience to manage the redesign and relocation of its data processing systems. H-71

26. **Revenue Losses from Reducing Audit Staff to Absorb MSA Costs Are Unsubstantiated. Reduce Item 0860-001-001 by $3,369,000.** Recommend deletion of the augmentation to fund MSA costs because board is unable to provide basis for its contention that audit recoveries will be adversely affected. H-74

		Analysis Page
27.	**Augmentation to Administer Refund Program Should Be Contingent on Court Decision.** Recommend Budget Bill language making the $3.1 million augmentation to administer refunds contingent on court ruling in support of state's reimbursement plan.	H-76
28.	**Board Should Report its Costs to Administer Refund Program.** Recommend that board report its cost to administer refund payments for invalidated county sales taxes.	H-76
29.	**Budget Does Not Reflect Anticipated Savings from Electronic Funds Transfers.** Withhold recommendation on augmentation of $501,000 to administer the EFT program, until the board can show the savings from the program.	H-77
30.	**Board Has Not Considered Alternative Strategies to Address Cigarette Tax Evasion. Reduce Item 0860-001-230 by $363,000.** Recommend that the augmentation for the cigarette and tobacco tax compliance staff be denied.	H-78

Franchise Tax Board

31.	**Recommend Reduction to Reflect Completion of One-Time Audit Workload. Reduce Item 1730-001-001 by $900,000.** Recommend that the budget be reduced to reflect a one-time audit workload completed in 1993-94.	H-80
32.	**Withhold Recommendation on Augmentation for Workload Growth.** Withhold recommendation on the augmentation to accommodate workload growth pending review of tax return volume estimates which reflect revisions to economic forecasts.	H-81
33.	**The FTB Should Report Basis for Compliance Fees to Legislature.** Recommend that the FTB report to the Legislature at budget hearings the basis for proposed filing enforcement and collection fees.	H-82

Department of General Services

Departmental Performance Issues

	Analysis Page
34. **Performance Budgeting Progress.** There is little evidence of performance budgeting as a result of the department's participation in the administration's performance budget pilot program.	H-85
35. **Efforts to Improve Department's Performance.** There is some evidence of the department's efforts to improve performance.	H-87

Expenditure Accountability Issues

36. **Notifying the Legislature of Augmentations.** Recommend Budget Bill language requiring notification to the Legislature of authorized augmentations made by the Directors of General Services and Finance.	H-90
37. **Paying Private Printers for Work.** Withhold recommendation on $964,000 requested to make payments to private printers on behalf of client agencies pending the department's consideration of additional alternatives.	H-91

California State Police Issues

38. **Review of State Police.** Recommend supplemental report language requiring the department to conduct a review in order to align California State Police officer assignments more closely to basic statutory responsibilities, and to determine a more appropriate method of funding the state police.	H-92
39. **Positions Not Justified. Reduce Item 1760-001-666 by $112,000.** Recommend deletion of $112,000 to fund two new police officer positions which are not needed by the California State Police to perform its primary responsibilities.	H-94

Division of the State Architect Issues

40. **Seismic Program—State Buildings.** Recommend deletion of $1.5 million in bond funds for building evaluations because the bond funds should instead be used to retrofit state buildings for earthquake safety. Delete $1.5 million from Item 1760-001-768.	H-95
41. **Bonds Should Be Used for Earthquake Safety Improvements.** Recommend the Legislature adopt Budget	H-96

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Bill language clarifying that priority for the use of bond funds is for seismic-related building improvements.

42. **Additional Architectural/Engineering Staff Not Needed.** Recommend the Legislature not authorize additional architectural/engineering staff because workload increases can be addressed with consultant contracts. Also recommend the Legislature modify proposed Budget Bill language to prevent the Division of the State Architect from adding staff not authorized by the Legislature. Delete $628,000 in Item 1760-001-602. H-97

Office of Buildings and Grounds Issues

43. **Operating and Maintaining New Buildings.** Recommend the department clarify its intent with regard to providing janitorial and maintenance services for three new state office buildings in Sacramento. H-98

44. **Building Rental Account—Base Funding.** Recommend Budget Bill language that increases the department's base funding for special repairs to $2.2 million. H-99

45. **Building Rental Account—Use of Excess Funds**. Recommend modifying Budget Bill language to allow year-end balance in Building Rental Account to be used for special repairs/deferred maintenance projects instead of being transferred to the General Fund. H-99

46. **Building Rental Account—Rate Increase.** Recommend supplemental report language stating legislative intent that building rental rate be increased in 1995-96 to a level sufficient to address the department's deferred maintenance backlog. H-99

Other Statewide Support Services Issues

47. **Improving the State's Fleet of Vehicles.** Recommend supplemental report language requiring the department to report to the Legislature on ways to improve the cost-effectiveness of fleet operations. H-101

Department of Finance

	Analysis Page
48. **Office of Information Technology.** Withhold recommendation on $2 million to fund the OIT pending further evaluation of the office's performance.	H-103
49. **Performance Budgeting Pilot Program.** The program has produced few results and is behind schedule.	H-104

Control Section 13.90—Transfer of Financing Agency Balances to the General Fund

50. **Proposed Transfers Need Further Review.** Withhold recommendation on proposed fund balance transfers and recommend that Legislature conform action on this proposal to action on budget for California Revenue Bond Financing Authority.	H-105

Commission on State Mandates

51. **School Crime Mandate.** We recommend that the Legislature make the School Crimes Reporting mandate optional until a reliable school crimes reporting system can be established. (Reduce Item 8885-111-001 by $902,000).	H-107

	Analysis Page
52. **Deferred Mandate Costs.** The budget does not provide funds to pay the deferred costs of two mandates and double-budgets the 1994-95 cost of another mandate. The state's net unfunded mandate liability totals $21.7 million.	H-108
53. **STRS Mandate Costs.** We recommend a general fund reduction totaling $6.2 million in the amounts scheduled for two school mandates, because the requested amounts are overbudgeted. (Reduce Item 8885-111-001 by $6.2 million)	H-109

Stephen P. Teale Data Center

54. **Mainframe Computer Procurement Demonstrates Problems**. Procurement of computer discloses problems with the data center's procurement process and capacity management.	H-110
55. **Unsound Contract**. The contract with the DMV for network services is fiscally unsound and has exposed other data center clients to an unfunded liability.	H-112
56. **Contract Should Be Renegotiated**. Recommend Budget Bill language requiring that the contract with the DMV for network services be renegotiated to remove billing inequities and release other clients from an unfunded liability.	H-114
57. **Emphasis on Large Mainframe Computers**. The data center continues to emphasize expanding mainframe capacity while national trends are toward alternative computing methods.	H-114
58. **Legislative Intent Ignored**. Recommend Budget Bill language to ensure that the Legislature will receive timely notice of major computer projects.	H-116
59. **Independent Review Needed**. Recommend supplemental report language requiring an independent review of billing and cost recovery practices to bring practices in line with state policy.	H-116
60. **Better Oversight Needed**. Recommend legislation to create a Board of Directors to oversee the operation of the data center. Recommend the Department of Finance	H-117

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administratively establish an advisory board to the OIT to function until legislation is enacted.	
61. **Performance Budgeting**. The proposed budget does not reflect the data center's participation in the Governor's performance budget pilot program.	H-119
62. **Technical Overbudgeting Issues. Reduce Item 2780-001-683 by $2.6 million.** Recommend reduction due to overbudgeting.	H-119
63. **New Computer Facility**. Withhold recommendation on $135,000 proposed for services associated with establishing a new computer facility pending an explanation of the data center's plans.	H-119

Health and Welfare Agency Data Center

64. **The Statewide Automated Welfare System (SAWS) Needs Further Review.** Withhold recommendation on $17.8 million proposed to support the Department of Social Services' SAWS project pending legislative review of the fiscal and policy issues concerning the project.	H-121
65. **Kiosk Project Evaluation Plan Should Be Expanded.** Recommend adoption of supplemental report language directing center to expand its planned evaluation of the program to include an assessment of the costs and benefits to the state agencies buying service.	H-122

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Office of Emergency Services

66. **Information System Needs to Be Developed.** Recommend adoption of supplemental report language requiring a specific plan to implement a computer-based system to meet the need for information relating to disasters. H-124

67. **Improvement Needed to Provide Information on Assistance Programs.** Recommend adoption of supplemental report language requiring the evaluation of methods to improve the dissemination of information relating to disaster assistance programs. H-127

Board of Control

68. **Shortfalls Continue in Victims of Crime (VOC) Program.** Recommend that board report during budget hearings on status of funding of the VOC Program. H-129

69. **Claims for Special Election Costs.** Recommend that board report during budget hearings on implementation of Ch 39/93 to fund special election costs. Further recommend that verified claims be placed in annual claims bill. H-134

Department of Veterans Affairs

70. **Lack of Demand for Additional Veterans Homes.** Withhold recommendation on $840,000 and ten positions for the new Barstow home, pending report during budget hearings on the demand for the homes. Further recommend legislation to remove authority to construct any new homes. H-136

71. **Member Fee Structure Needs Improvement.** Recommend that the Legislature amend the Budget Bill language to ensure that the department may recover as much of the cost of member services as possible. Also recommend that the department and the Bureau of State Audits (BSA) report during budget hearings on the final findings and recommendations of the BSA's review of the department's attempts to maximize reimbursements. H-139