

**STATE OF CALIFORNIA
FINANCE LETTER - COVER SHEET
FOR FISCAL YEAR 2008/09
DF-46 (REV 07/06)**

**Department of Finance
915 L Street
Sacramento, CA 95814
IMS Mail Code: A-15**

FL # 2	PRIORITY NO	ORG CODE 1730	DEPARTMENT Franchise Tax Board
PROGRAM 60 Court Collections	ELEMENT 60 Court Collections	COMPONENT	

TITLE OF PROPOSED CHANGE:

Court Ordered Debt Collection Expansion - General Fund Loan

SUMMARY OF PROPOSED CHANGE:

This proposal is requesting to shift the funding source for a significant portion of FTB's Court Ordered Debt Expansion (CODE) project from the Court Collection Account to a General Fund loan. The requested loan would amount to \$4.4 million in FY 08/09 and \$853,000 in FY 09/10.

REQUIRES LEGISLATION <input type="checkbox"/> YES <input checked="" type="checkbox"/> NO	CODE SECTION(S) TO BE AMENDED/ADDED	BUDGET IMPACT-PROVIDE LIST AND MARK IF APPLICABLE <input type="checkbox"/> ONE-TIME COST <input type="checkbox"/> FULL-YEAR COSTS <input type="checkbox"/> FACILITIES/CAPITAL COSTS <input type="checkbox"/> FUTURE SAVINGS <input type="checkbox"/> REVENUE
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PREPARED BY:	DATE	REVIEWED BY:	DATE
PROGRAM APPROVAL:			
DEPARTMENT DIRECTOR:	DATE	AFFECTED DEPARTMENT:	DATE

Pending Approval

DOES THIS BCP CONTAIN INFORMATION TECHNOLOGY (IT) COMPONENTS? YES OR NO
IF YES, DEPARTMENTAL CHIEF INFORMATION SIGNATURE DATE

FOR INFORMATION TECHNOLOGY REQUESTS, SPECIFY THE DATE SPECIAL PROJECT REPORT (SPR) OR FEASIBILITY STUDY REPORT (FSR) WAS APPROVED BY THE DEPARTMENT OF FINANCE.

DATE PROJECT # FSR OR SPR

IF PROPOSAL AFFECTS ANOTHER DEPARTMENT, DOES OTHER DEPARTMENT CONCUR WITH PROPOSAL? N/A

YES NO ATTACH COMMENTS OF AFFECTED DEPARTMENT SIGNED AND DATED BY THE DEPARTMENT DIRECTOR OR DESIGNEE.

DEPARTMENT OF FINANCE ANALYST USE (ADDITIONAL REVIEW)

CAPITAL OUTLAY OTROS FSCU OSAE CALSTARS

DATE SUBMITTED TO THE LEGISLATURE: PPBA:

FL #2	DATE	Title of Proposed Change: CODE - General Fund Loan COMPONENT	Personnel Years			CY	BY	BY + 1
			CY	BY	BY + 1			
PROGRAM 60 Court Collection	02/13/2008 ELEMENT 60 Court Collection							
Total Salaries & Wages a/			.0	.0	.0	\$ 0	\$ 0	\$ 0
Salary Savings			.0	.0	.0	\$ 0	\$ 0	\$ 0
Net Total Salaries and Wages			.0	.0	.0	\$ 0	\$ 0	\$ 0
Staff Benefits b/						\$ 0	\$ 0	\$ 0
Total Personal Services						\$ 0	\$ 0	\$ 0
Operating Expenses and Equipment								
General Expenses						\$ 0	\$ 0	\$ 0
Printing						0	0	0
Communications						0	0	0
Postage						0	0	0
Travel-In-State						0	0	0
Travel Out-of-State						0	0	0
Training						0	0	0
Facilities Operations						0	0	0
Utilities						0	0	0
Cons & Prof Svs - Interdept'l						0	0	0
Cons & Prof Svs - External						0	0	0
Consolidated Data Center						0	0	0
Data Processing						0	0	0
Equipment						0	0	0
Other Items of Exp (Specify Below)						0	0	0
Total Operating Expense & Equipment						\$ 0	\$ 0	\$ 0

a/ Itemized detail on Page II-3 by classification as in Salaries and Wages Supplement.

b/ Detail provided on following pages.

TOTAL OPERATING EXPENSES AND EQUIPMENT

<u>CY</u>	<u>BY</u>	<u>BY + 1</u>
\$ 0	\$ 0	\$ 0

SPECIAL ITEMS OF EXPENSE d/

\$ 0	\$ 0	\$ 0
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PROGRAM ADMINISTRATION
Distributed Admin

\$ 0	\$ 0	\$ 0
\$ 0	\$ 0	\$ 0

TOTAL STATE OPERATIONS EXPENDITURES

\$ 0	\$ 0	\$ 0
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Source of Funds

Appropriation No.

	Org	- Ref	- Fund
General Fund	1730	001	0001
Court Collection	1730	001	0242
Reimbursements	1730	501	0995

\$ 0	\$ 4,400,000	\$ 853,000
0	-\$ 4,400,000	-\$ 853,000
0	0	0
0	0	0
0	0	0
0	0	0
0	0	0
\$ 0	\$ 0	\$ 0

Totals

LOCAL ASSISTANCE

	Org	- Ref	- Fund
General Fund	1730	001	0001
Court Collection	1730	001	0242
Reimbursements			
Totals			

\$(0)	\$(0)	\$(0)
\$ 0	\$ 0	\$ 0
0	0	0
0	0	0
0	0	0
0	0	0
0	0	0
\$ 0	\$ 0	\$ 0

d/ Special Items of expense must be titled. Please refer to the Uniform Codes Manual for a list of the standardized Special Items of expense objects which may be used.

FRANCHISE TAX BOARD
Fiscal Year 2008/09

Finance Letter
Court Ordered Debt Collection Expansion -
General Fund Loan

FL No. 2
DATE: February 13, 2008

A. NATURE OF REQUEST

This proposal is requesting to shift the funding source for a significant portion of FTB's Court Ordered Debt Expansion (CODE) project from the Court Collection Account to a General Fund loan. The requested loan would amount to \$4.4 million in FY 08/09 and \$853,000 in FY 09/10.

The Franchise Tax Board (FTB) submitted a FY 2008/09 BCP requesting funding of \$3.9 million and a total of 56.5 positions for the Court Ordered Debt (COD) Collection Program and the Court Ordered Debt Expansion (CODE) Project. This BCP provides the budget authority needed to fund the program and the project. FTB is not requesting to change that budget authority. However, because current revenue projections are falling, FTB cannot spend the entire budget authority and maintain the legislative intent to keep administrative costs at or below 15% of collections. Therefore, an alternate funding source is requested in the form of a General Fund loan.

B. BACKGROUND/HISTORY

Legislative Authority:

Pursuant to AB 3343 (Chapter 1242, Statutes of 1994), the COD Collection Program has authority to collect delinquent court-imposed fines, penalties, forfeitures, and restitution orders. The three primary clients are Superior Courts, Probation Departments, and Revenue Recovery Agencies. Generally, each agency refers a variety of cases depending on the type of violations in their jurisdiction.

The COD program has collected over \$367 million for its participating clients from inception in 1995 through December 2007. Revenue collected by the program supports numerous county and state funds, i.e., County Special Account, County General Fund, State Restitution Fund, Victims-Witness Assistance Fund as well as the State General Fund. Administrative costs are reimbursed at a rate of up to 15% of program collections, as authorized by legislation. SB 246 (Chapter 380, Statutes of 2004) established FTB's COD Collection Program as permanent, requiring FTB to offer collection services for all counties and superior courts statewide.

CODE Project

To comply with SB 246, FTB in 2004 initiated the development of a collection system capable of accepting all referrals from all counties and courts. The use of this collection system by the courts is voluntary. FTB is currently in Phase I. Each Phase of this project is sequential and builds upon the previous phase with the necessary functionality that will ultimately produce a state of the art collection system.

Phases I and II of the CODE Project implementation will facilitate the statewide expansion with the deployment of a new database, more frequent updates with the clients, collection system enhancements and compliance with security and data retention policies. This system must have the ability to accommodate statewide expansion with estimates of up to 8 million cases. In FY 2006/07, the program included 45 clients. It is anticipated to increase to 85 clients by FY 2008/09 and to at least 95 clients by FY 2009/10.

By statute, the program is funded through actual collections. The program (pre-project years) has always stayed below the 15% spending cap as shown below.

Table 1 - % Cost/Revenue - Pre-Project

	FY 01/02	FY 02/03	FY 03/04	FY 04/05	FY 05/06	5-Yr Ave
Revenue	\$23,688,066	\$23,439,005	\$38,695,583	\$63,423,990	\$55,153,165	\$40,879,350
Expenses	\$2,645,855	\$3,472,338	\$4,804,890	\$5,696,609	\$6,037,375	4,521,930
Cost Percentage	11.2%	14.8%	12.4%	9%	10.9%	11.7%

Originally, funding for the CODE Project was to be paid with the difference between actual administrative costs and 15% of revenue cap. However, with the additional costs associated with the CODE project as well as the shortfall in revenues, the overall COD program (including the project) will be unable to maintain expenses at or below 15% of revenue collected.

Table 2 - % Cost/Revenue - Program vs. Project

	Actual Revenue/ Revised Projection	PROGRAM Actual Costs /Projected Costs	Program Only Cost %	PROJECT Actual Costs/Projected Costs	Total Costs- Program and Project	Program and Project Cost %
FY 2006/07	\$72,000,000	\$8,187,000	11.4%	\$2,360,000	\$10,547,000	14.6%
FY 2007/08	\$69,500,000	\$7,443,000	10.7%	\$5,345,000	\$12,788,000	18.4%
FY 2008/09*	\$72,000,000	\$9,723,000	13.5%	\$5,472,000	\$15,195,000	21.1%
FY 2009/10*	\$74,000,000	\$9,632,000	13.0%	\$2,321,000	\$11,953,000	16.2%
FY 2010/11*	\$76,000,000	\$9,675,000	12.7%	\$1,276,000	\$10,951,000	14.4%

- For FY 08/09 increase in costs reflect 26.5 new PYs. As events unfold the number of PYs will be reevaluated and a negative BCP will be submitted for subsequent years, if appropriate.
- For FY 09/10 and FY 10/11-maintenance costs are not included.

In order to conform to the legislative intent related to the 15% cap in FY 07/08, FTB has been working with the AOC to obtain the approval of the Judicial Council to use part of the surplus in the Court Collection Account (CCA) reserve. ¹This will enable FTB to continue planned CODE project efforts. However, the CCA balance is projected to be insufficient to cover the projected deficits for FY 08/09 and FY 09/10.

¹ FTB received the letter of concurrence in October 2007 authorizing use of \$1.5 million to cover any 2007/08 revenue shortfalls for the CODE Project expenditures. We recently requested additional funding from this account to cover the project expenditures.

The following table provides detail of projected revenue, program and project expenditures and budget and spending authority for FY 2007/08 – 2010/11.

Table 3 – Revised Spending Authority Deficit/Surplus

	FY 07/08 Projected	FY 08/09 Projected	FY 09/10 Projected	FY 10/11 Projected
Revenue	\$69,500,000	\$72,000,000	\$74,000,000	\$76,000,000
Expenses-Program	\$7,443,000	\$9,723,000	\$9,632,000	\$9,675,000
Program only Cost %	10.7%	13.5%	13.0%	12.7%
Exp.- Project – One-time*	\$5,245,000	\$4,800,000	\$1,194,000	\$0
Project- Ongoing	\$100,000	\$672,000	\$1,127,000	\$1,276,000
Total Project Costs	\$5,345,000	\$5,472,000	\$2,321,000	\$1,276,000
Project Cost %	7.7%	7.6%	3.1%	1.7%
Total Expenses	\$12,788,000	\$15,195,000	\$11,953,000	\$10,951,000
Total Cost %	18.4%	21.1%	16.2%	14.4%
Budget Authority	\$12,787,734	\$15,200,000	Pending*	Pending*
Spending Authority (15%)	\$10,425,000	\$10,800,000	\$11,100,000	\$11,400,000
Projected Deficit	(\$2,363,000)	(\$4,395,000)	(\$853,000)	\$449,000
CCA support	\$2,363,000			
Spending Authority Revised Deficit/surplus GF Loan	\$0	(\$4,395,000)	(\$853,000)	\$449,000

* Note FYs 09/10 and 10/11 does not include additional PYs requested in BCP 7.

FTB is requesting a loan from the General Fund to cover the deficit resulting from the CODE Project costs for FY 08/09 and FY 09/10. As reflected in the table above, projected “spending authority” deficits in FY 08/09 and FY 09/10 are \$4.4 million and \$853 thousand respectively. A loan will allow us to successfully implement CODE Project to meet legislatively mandated compliance. Repayments of this General Fund loan would be made each year that 15% of collection revenues exceed administrative costs until the balance and interest are paid in full. We estimate the initial payment on this GF loan will occur in FY 2010/11 as shown above.

C. STATE LEVEL CONSIDERATIONS

This proposal will enable all California courts and counties to benefit from the COD Collection Program enhancement through statewide implementation. The COD Collection Program benefits both courts and counties that rely on the State General Fund and special funds to operate their programs. Revenue collected from the COD Collection Program supports numerous county and state funds, i.e., County Special Account, County General Fund, State Restitution Fund, and the Victims-Witness Assistance fund.

The Administrative Office of the Courts (AOC) and the Judicial Council view FTB as a viable collection agent that enables courts and counties to maximize the collection of court imposed fines and fees and is working closely and collaboratively with FTB to ensure the continued success of the COD Program and the successful statewide implementation of the CODE Project.

D. FACILITY/CAPITAL OUTLAY CONSIDERATIONS

Since this FL only requests a shift in funding source from the Court Collection Account to the General Fund, there are no facility concerns associated with this proposal.

E JUSTIFICATION

FTB's mission is "to collect the proper amount of tax revenue, and operate other programs entrusted to us, at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness." This proposal fully supports FTB's Strategic Plan Goal #5 "Demonstrate Operational Excellence."

Due to the drop in projected revenues and increased costs, FTB cannot continue to maintain the legislative intent to keep expenditures at or below 15% of collections.

Factors contributing to decreased revenue projections:

As indicated in the FSR, FY 2004/05 was used as a baseline for future years in the original projections. The methodology used to project revenue took into account the actual revenue figures from 2004/05 plus the anticipated new & existing client growth for the next five years. Per Legislation, participation in the COD program is entirely voluntary for the counties and Superior Courts. The original projections assumed all counties & Superior Courts would participate upon implementation. Revised projections assume a phased approach for client participation and assume those identified clients will voluntarily participate.

In addition, the following factors contributed to the decrease in revenue from the original projections:

1. FY 2004/2005 turned out to be an exceptionally high revenue year leading to unrealized revenue projections. We could not identify specific causes for this anomaly; however, we believe it was based on a good economy at the time, which in subsequent years, changed.
2. Fewer new clients chose to participate since the original projections.
3. In FY 2005/06 and FY 2006/07, two clients withdrew a significant number of cases.
4. Existing clients case growth was slower than projected.
5. Debts received by FTB have increasingly become 3rd placement debts. Some courts have chosen to contract with other private collection agencies to work these cases before they are sent to us. Consequently, when the debt is placed with us, this 3rd placement debt is less collectable.
6. FY 2007/08 projection is reduced to reflect updated new client participation and case volumes.
7. FY 2008/09, FY 2009/10, and FY 2010/11 revenue is updated to reflect revised new client participation and case volumes. Note: This is not lost revenue but is deferred revenue to future years. Future BCP requests for positions will use this approach.

Factors contributing to increased costs:

While revenue was decreasing from original projections, the average cost to process the COD cases is rising. Recent changes in policy require FTB to send more demand notices prior to taking involuntary collection action to ensure debtors receive due process. Historically, only 20% of

revenue is generated from demand notices. The bulk of the revenue is realized only as you move into the involuntary collection stage. So these additional required demand notices are not producing added revenue. They are only adding to the program cost (in terms of printing, postage and labor). This is also increasing the volume of calls received. The program is sending out more mail, but the revenue per piece of mail is down – we are working harder but receiving lower payments. Also effective January 2008, due to AB 367, FTB’s threshold to accept court accounts was lowered to \$100. This will result in an increase in case volume, and payment volume. However, as shown on the chart below, the revenue per payment is not expected to increase.

Table 4 – Revenue Collected Per Case Action

	FY 05/06 Actual	FY 06/07 Actual	FY 07/08 Projected	FY 08/09 Projected	FY 09/10 Projected
Revenue	\$ 55,153,000	\$72,081,000	\$69,500,000	\$72,000,000	\$ 74,000,000
Workload					
Call Volume	193,213	253,711	230,479	276,545	301,434
Notice Volume (Case Action)	949,486	1,278,255	1,794,000	1,870,000	1,883,000
Avg. \$ Collected per Case Action	\$58	\$56	\$39	\$39	\$39

This proposal is critical and cannot be deferred to the 2009-10 budget process. Deferring this until 2009-10 would result in a deficit of \$4.4 million for FY 08/09. This would also result in the termination of the project. Without the completion of at least the first phase of the new collection system, FTB will be unable to accommodate statewide expansion as mandated by SB 246.

F. OUTCOMES AND ACCOUNTABILITY

This Finance Letter is supported by a fully developed FSR 1730-182, which provides detail of the project implementation plan to develop a collection system that ensures the program has the ability to support all potential statewide clients in a manner that reflects best collections practices. As part of the CODE Project, FTB executive management established the CODE Project Steering Committee. The committee reports directly to the Executive Sponsor and to the Executive Officer. The CODE Project Steering Committee acts as an advisor and counsel for the project and resolves any issues that cannot be resolved by the project team. A Project Manager, working in conjunction with the department’s Project Oversight and Guidance (POG) office, oversees the progress of the project to ensure all applicable guidelines and procedures are addressed. The Project Manager and staff of POG monitor monthly progress, monthly project expenditures, and resource usage and ensure proper internal and external reports are completed timely.

The CODE Project also retains an Independent Verification and Validation (IV&V) and Project Oversight (PO) body to perform in an advisory role. This role is independent and separate from the day-to-day operations of the project. The Independent Project Oversight Consultant, “i3 tech Data Solutions, Inc.,” prepares the quarterly Independent IT Project Oversight Report (IPOR) for the Department of Finance. POG also completes monthly Project Status Reports (PSR).

G. ANALYSIS OF ALL FEASIBLE ALTERNATIVES

Alternative #1 – Approve loan from the General Fund of \$4.4 million to cover CODE Project expenses for FY 08/09. This would allow the project to continue as well as keep the COD Program within its spending cap authority.

A loan from the General Fund would allow FTB’s COD Collection program to successfully implement the CODE Project to meet legislatively mandated compliance. Repayments of this General Fund loan would be made each year that 15% of collection revenues exceed administrative costs until the balance and interest are paid in full. We estimate the initial payment on this GF loan will occur in FY 2010/11 as in Table 3 on page 3.

Alternative # 2 – No General Fund loan / reduce scope of CODE project to cancel Phase II and Phase III on 12/31/08. Any resulting increase in the deficit in spending authority will be covered from Court Collection Account.

This alternative would end the project on 12/31/08 without the implementation of Phase II and Phase III. This option would allow the implementation of the COD collection system and the security requirements. However, this option would not bring the COD collection methods into conformance with the best practices used in tax collections. In addition, Phase III of the project adds the ability to query live data and create reports – a much needed management tool. Phase III also allows debtors to access their accounts via the web, which would relieve some of the anticipated increase in call volumes from debtors.

This alternative could save an estimated \$3 million initially. However, the estimated cost to restart the project to complete Phase II and Phase III could cost in excess of \$5 million. This is based on the amount of the project budget we have allocated for Phase II & III plus project startup and staffing estimates.

H. TIMETABLE

Funding to be provided on July 1, 2008.

I. RECOMMENDATION

Alternative # 1 is recommended. This alternative will allow the CODE Project to continue as scheduled through Phase II of the implementation of the new collection system. This would also allow the program to remain within the 15% spending cap that is required by statute. By October of 2008, the collection system will be in production allowing FTB to accept all potential clients. This alternative fulfills the requirements of SB 246 and makes FTB collection services available to all potential clients.