Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 5 Agenda

Senator Loni Hancock, Chair
Senator Joel Anderson
Senator Curren D. Price, Jr.

Thursday, March 7, 2013
9:30 a.m. or Upon Adjournment of Session
Room 113

Consultant: Kris Kuzmich

DEPARTMENTS TO BE HEARD

(Please See Page 2 for Detailed Agenda Listing Specific Departments and Issues to Be Heard)

6645	CSU Health Benefits for Retired Annuitants
7100	Employment Development Department
7350	Department of Industrial Relations
7501	Department of Human Resources
7503	State Personnel Board
7900	Public Employees' Retirement System
7920	State Teachers' Retirement System
9650	Health and Dental Benefits for Annuitants
CS 3.60	Contribution to Public Employees' Retirement Benefits

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DETAILED AGENDA
Items 1-6 (and in Italics) are proposed Vote-Only

Item **Department** **Page**

6645/9650 Health and Dental Benefits for Annuitants (Including CSU) 3
Issue 1 – Retiree Health Budget Bill Provisional Language 3

7503 State Personnel Board 5
Issue 2 – Compliance Review Audit Program Budget Trailer Bill Language 5

7920 State Teachers' Retirement System 6
Issue 3 – Information Technology Project Budget Reappropriation Item 6

7100 Employment Development Department 7
Issue 4 – Disability Insurance Automation Project 7
Issue 5 – Alternative and Renewable Fuel and Vehicle Technology Program Reimbursable Budget Authority 8

7350 Department of Industrial Relations 9
Issue 6 – Child Performer Services Permits 9

SUMMARY CHART OF PROPOSED VOTE ONLY ITEMS 10

7501/7503 Department of Human Resources/State Personnel Board 11
Issue 7 – Additional Appointments of Exempt Employees 11

7501 Department of Human Resources 14
Issue 8 – Implementation of In-Home Supportive Services Employer-Employee Relations Act 14
Issue 9 – Salary Compaction 17

7900 Public Employees' Retirement System 19
Issue 10 – Administration of Health Benefits Programs for State Active Employees and Retirees 19

3.60 Contribution to Public Employees' Retirement Benefits 21
Issue 11 – Employer Pension Contribution Savings Directed to State's Unfunded Pension Liability 21

7100 Employment Development Department 22
Issue 12 – Unemployment Insurance Loan Interest Payment 22

7350 Department of Industrial Relations 25
Issue 13 – Implementation of Workers Compensation Reform 25
Issue 14 – Cal/OSHA Program, Enforcement of Workplace Safety and Health Standards 29
Issue 15 – Regulatory Assessment Related Budget Proposals 32

Items Proposed for Vote Only – Issue Descriptions

6645 CSU HEALTH BENEFITS FOR RETIRED ANNUITANTS
9650 HEALTH AND DENTAL BENEFITS FOR ANNUITANTS

Issue 1 – Retiree Health Budget Bill Provisional Language

Governor's Budget Request. The January budget requests new budget bill provisional language to authorize the California Public Employees Retirement System (CalPERS) to correct a defined set of errors in the calculation of service credit for the vesting of post-retirement health and dental benefits that occurred prior to the implementation of the MyCalPERS system.

Background. Through the Public Employees' Medical and Hospital Care Act (PEMHCA), the Legislature vests responsibility for managing health care programs for state workers, state retirees, and employees or retirees of participating local agencies with CalPERS. Budget Items 6645 and 9650 contain appropriations for these costs for state retirees. Item 6645 pertains to CSU health benefits for retirees and totals $278.2 million GF ($792,000 other funds). Item 9650 pertains to health and dental benefits for state retirees and totals $1.5 billion GF ($4 million other funds). Currently, nearly 270,000 state and CSU retirees and dependents are members of health plans administered by CalPERS.

Historically, CalPERS manually calculated service credit for the vesting of post-retirement health and dental benefits. When the new MyCalPERS system went "live" in 2011 it was revealed that a small number of errors had occurred in the initial vesting calculation for individual retirees. These errors impacted 92 retirees whose vesting percentage was set too low and three retirees whose vesting percentage was set too high. In sum, the underpayments totaled $750,000 and the overpayments totaled $2,100.

Staff Comment. CalPERS worked with the Department of Finance (DOF) to identify a solution to correct both the underpayments and overpayments; the result is the new budget bill provisional language in Budget Items 6645 and 9650. The proposed language applies to 2013-14 only. While this is expected to be one-time issue, it is possible that additional errors could come to light (albeit on an even smaller scale) in future years. If that proves to be correct, this language would repeat in future budget bills but the threshold would be lowered. DOF would be responsible for modifying the language in the fall through its work to develop the annual January Governor's Budget proposal.

In considering this request, the Subcommittee may wish to: (1) place a limit on funding available for this purpose in 2013-14; and (2) incorporate a legislative reporting requirement. With regard to the latter, given that the total amount of the underpayments is known ($750,000), it would be appropriate to limit the funding for the correction of calculation errors to "up to $1 million" of the appropriation.

Staff Recommendation: Approve placeholder budget bill provisional language as modified:

> *Items 6645 and 9650*
> *Provision x. Up to $1,000,000 of ~~T~~this appropriation shall also be available for the purpose of reimbursing state annuitants' share of health premiums from prior years or*

the current year due to a correction of errors or omissions in calculating service credit for the vesting of post-retirement health and dental benefits. *<u>The California Public Employees' Retirement System shall report to the Legislature before October 1, 2013 (1) the number of annuitants who received or will receive a reimbursement pursuant to this provision, (2) the amount of money reimbursed or will be reimbursed to annuitants pursuant to this provision, (3) the number of annuitants who reimbursed or will reimburse the state pursuant to this provision, and (4) the amount of money reimbursed or will be reimbursed to the state pursuant to this provision.</u>*

Items Proposed for Vote Only – Issue Descriptions

7503 STATE PERSONNEL BOARD

Issue 2 – Compliance Review Audit Program Budget Trailer Bill Language

Governor's Budget Request. The January budget requests budget trailer bill language to authorize the State Personnel Board to bill departments on a pro rata basis for the costs of its Compliance Review Audit Program.

Background. In part, the Governor's Reorganization Plan No. 1 of 2011 (GRP 1-2011) consolidated the state's human resource management functions and authorities previously vested with the State Personnel Board (SPB) and Department of Personnel Administration, except for the constitutional responsibilities of the SPB, into the California Department of Human Resources (CalHR). The GRP 1-2011 was effective on September 9, 2011.

Consistent with this aspect of the GRP 1-2011, the SPB continues to act as an independent five-member Board within CalHR, appointed by the Governor and serving ten-year terms, to hear merit appeals and oversight of the merit principle. CalHR continues to provide administrative and staffing support to enable the SPB to accomplish its mission. The GRP 1-2011 also retained within the SPB, 11 positions and $1.5 million (reimbursements) to allow the SPB to reinstate its Compliance Review Audit Program. This program ensures that departmental level personnel policies are in compliance with civil service statutes and board regulations that enforce the merit principle.

Staff Comment. The SPB has not had a dedicated audit program since the early 1990s. The GRP-1 2011 addressed this and provided authorization for the SPB to bill departments in arrears for these reviews in order to restart this program. However, due to a number of factors, including the size of the reviewed department and the quality and quantity of identified merit related issues, the SPB is unable to provide departments with an accurate cost of a review to allow a given department to budget appropriately. The pro rata billing option presented in this request enables departments to budget for a set amount annually. Departments have expressed a desire to have the option to pay on a pro rata basis.

The SPB indicates that they will report annually to the board on the results of the Compliance Review Audit Program. In considering this request, the Subcommittee may wish to consider amending the trailer bill language to require the SPB to provide a copy of the annual report to the appropriate committees of the Legislature.

Staff Recommendation: Approve placeholder budget trailer bill language as modified to include transmission of the annual report on the Compliance Review Audit Program to the Legislature.

> *Government Code 18662 (e) On or before October 1, 2014, and every October 1 thereafter, the board shall report to the Chair of the Joint Legislative Budget Committee its audit and special investigation activities pursuant to this section from the preceding fiscal year. Specifically, the board shall report:*
> *(1) A summary of each audit and special investigation, including findings.*
> *(2) By department, the number and total cost of audits and special investigations.*

Items Proposed for Vote Only – Issue Descriptions Continued

7920 STATE TEACHERS' RETIREMENT SYSTEM

Issue 3 – Information Technology Project Budget Reappropriation Item

Prior Budget Action. The Budget Act of 2012 established a new budget item and associated language to address funding continuation issues associated with some of the State Teachers' Retirement System (STRS) major information technology projects. The proposal allowed additional flexibility to address situations where projects entail complex and multi-year commitment of funds by authorizing three years for funds to be encumbered and two years for funds to be liquidated. Previously, the period of time for these two actions to occur was one year and two years. This budget item also incorporated an existing quarterly reporting requirement to the Legislature and Department of Technology detailing the status of STRS's technology projects.

Governor's Budget Request. The January budget, consistent with the prior budget action described above, reappropriates up to $6.749 million (Teachers Retirement Fund-TRF) from the Budget Act of 2012 for costs associated with information technology projects.

Staff Comment. Each year, the budget act allocates $18.5 million (TRF) for the support of technology projects. The changes in the Budget Act of 2012 brought additional transparency to these expenditures, as well as allowing STRS to use already appropriated funding for a longer period of time and thus the need to request additional resources in future years would be minimized or, in some cases, eliminated. At that time, STRS indicated its intent to "complete the loop" through the submission of reappropriation language.

In considering this request, the Subcommittee may wish to consider incorporating a quarterly report to the Legislature on the expenditure of the reappropriated funds. This approach would be modeled on the existing legislative reporting requirement tied to the $18.5 million in base budget funding for technology projects.

Staff Recommendation: Approve the reappropriation item as modified to incorporate quarterly reporting to the Legislature on the expenditure of the reappropriated funds.

Items Proposed for Vote Only – Issue Descriptions Continued

7100 EMPLOYMENT DEVELOPMENT DEPARTMENT (EDD)

Issue 4 – Disability Insurance Automation Project

Governor's Budget Request. The January budget requests a one-time augmentation of $10.6 million from the Disability Insurance fund and a redirection of $1.9 million from the same fund source to support a net of 26 positions (62 new positions less 36 existing positions) for the Disability Insurance Automation (DIA) project.

Background. Since 1946, the State Disability Insurance (SDI) program has provided temporary, partial wage replacement to eligible disabled workers who suffer a loss of wages when they are unable to work due to illness or injury. SDI is completely funded through employee payroll deductions and covers the majority of California employees.

Historically, the SDI program consisted of many complex manual operations; the paper based system was burdensome and inefficient to customers and EDD. The DIA project, which went "live" in October 2012, provides greater access to services for claimants, medical providers, and employers by allowing these individuals to use the Internet to submit claims data using a direct electronic interface or through web-based intelligent forms. This simplifies and automates the numerous manual work processes involved when a claim is filed with EDD. Further, optical character recognition has been implemented to convert remaining paper claims to electronic format. Automated business logic will allow "in pattern" claims to be paid automatically, further increasing service delivery.

The resources in this request will be used to support the DIA project during the second year of its operation and production, including enhancements and maintenance. Of the $12.5 million being requested, $10.6 is new Disability Insurance funds; the remaining $1.9 million will be redirected from savings achieved through the reduction of 36 Key Data Operator positions to fund ongoing project costs. The reduction in Key Data Operators is a result of the DIA project providing Web-based intelligent forms, which removes key data entry tasks from Disability Insurance branch employees, thus saving on the amount of staff required to administer the program.

Staff Comment. When the DIA project went "live" in 2012, claim processing time increased. This was expected as part of the transition to the online system, as not all claimants and medical providers immediately switched to electronic filing, resulting in EDD processing both paper and e-forms. This dynamic created additional workload that impacted the entire program. The EDD has undertaken extensive outreach and communication to the field to increase the number of e-filers. For instance, 80 percent of Kaiser providers are now filing electronically and Kaiser represents 31 percent of all providers. The EDD expects claim processing time to continue to improve in the coming months. The resources in this request also continue the necessary training of EDD staff in preparation for taking over the maintenance and operations functions from the system integration vendor.

Staff Recommendation: Approve the request.

Items Proposed for Vote Only – Issue Descriptions Continued

7100 EMPLOYMENT DEVELOPMENT DEPARTMENT

Issue 5 – Alternative and Renewable Fuel and Vehicle Technology Program Reimbursable Budget Authority

Governor's Budget Request. The January budget requests an ongoing reimbursable budget authority appropriation of $3 million to allow the Employment Training Panel (ETP) to provide services and support, including workforce development and training needs, related to the Alternative and Renewable Fuel and Vehicle Technology Program (ARFVTP).

This request also includes budget bill provisional language to allow the Department of Finance to increase the reimbursement authority by up to an additional $3 million for unused funds or additional grant awards from the California Energy Commission (CEC). Authority for reimbursements in excess of that amount will be requested via Control Section 28.50.

Background. Chapter 750, Statutes of 2007, created the ARFVTP, to be administered by the CEC, to develop and deploy innovative technologies that transform California's fuel and vehicle types to attain the state's climate change policies. In the years since the enactment of Chapter 750 and the ARFVTP, the CEC has partnered with the ETP via an interagency agreement to fund training required by California's emerging green transportation industry and support the CEC's workforce training goals for the ARFVTP.

LAO Recommendation. Approve the increase in reimbursements for the ETP but reject the provisional language. The provisional language would give the Administration authority to increase ETP's reimbursement budget by up to $3 million without legislative review. Control Section 28.5 already allows for mid-year reimbursement augmentations and includes a legislative review process.

Staff Comment. Staff has no concerns with the basic intent of this proposal, which is to provide reimbursement authority to allow the ETP to continue to partner with CEC and provide the necessary workforce training goals of the ARFVTP. However, similar to the LAO, staff finds no justification for the new budget bill provisional language allowing the reimbursement authority to be increased by up to an additional $3 million.

Staff Recommendation: Approve the request but reject the budget bill provisional language allowing the reimbursement authority to be increased by up to an additional $3 million.

Items Proposed for Vote Only – Issue Descriptions Continued

7350 DEPARTMENT OF INDUSTRIAL RELATIONS (DIR)

Issue 6 – Child Performer Services Permits

Governor's Budget Request. The January budget requests $701,000 (special fund) and eight positions in 2013-14, and $625,000 ongoing, to implement Chapter 634, Statutes of 2012, which requires persons representing artists who are minors to obtain a Child Performer Services Permit from the Labor Commissioner. The ongoing costs are reduced by $76,000 due to one-time equipment expenditures in the first year of implementation.

Background. Chapter 634 effectively creates a new permit process that will identify registered sex offenders and prohibit them from representing or providing services to minors who are performing or who are seeking to perform in the entertainment industry. Chapter 634 represents a new program for DIR; DIR currently estimates it will process 15,000 applications. Chapter 634 additionally requires individuals holding a Child Performer Services Permit to renew their permit on a biennial basis.

Chapter 634 requires DIR to collaborate with the Department of Justice (DOJ) and other law enforcement entities to ensure that each applicant is not a registered sex offender. An application fee will be charged to each applicant to pay for the full costs of administering the program. Applicants confirmed as non-sex offenders will be listed on a web site the Labor Commissioner is required to maintain of persons holding valid permits to provide these services to minors.

LAO Recommendation. Modify the Administration's request for eight permanent positions and $701,000 by approving the request on a two-year limited-term basis. This is a new program and the permit processing workload is largely unknown. Limited-term approval of this request would require the Administration to justify the appropriate ongoing staffing level for this program in a future budget proposal.

Staff Comment. Staff concurs with the LAO recommendation. While the implementation of Chapter 645 represents increased workload for DIR, it is not clear that the DIR estimate will prove correct yet the requested resources are proposed as permanent. Further, DIR and DOJ have yet to finalize the scope of the agreement/services DIR will receive from DOJ making it impossible to establish the level of the applicant fee. Therefore, in considering this request, the Subcommittee may wish to consider authorizing the resources on a two-year limited-term basis to allow the resource level to be revisited in two years' time when actual workload is known.

Staff Recommendation: Approve the request on a two-year limited-term basis.

SUMMARY CHART OF ITEMS PROPOSED FOR VOTE ONLY

	Issue	Amount	Fund Source	Staff Recommendation
	CSU Health Benefits for Retired Annuitants (6645) Health and Dental Benefits for Retired Annuitants (9650)			
1	Retiree Health Budget Bill Provisional Language	BBL	N/A	Approve BBL as modified to limit the amount available for the correction of calculation errors and to institute a legislative reporting requirement.
	State Personnel Board (7503)			
2	Compliance Review Audit Program Budget Trailer Bill Language	TBL	N/A	Approve TBL as modified to include transmission of the annual report on the Compliance Review Audit Program to the Legislature.
	State Teachers' Retirement System (1920)			
3	Information Technology Project Budget Reappropriation Item	$6.749 million BBL	Teachers Retirement Fund	Approve the reappropriation item including modified BBL to incorporate legislative reporting on the expenditure of the reappropriated funds.
	Employment Development Department (7100)			
4	Disability Insurance Automation Project	$10.6 million (new) $1.9 million (redirected) Net 26 positions	Disability Insurance Fund	Approve.
5	Alternative and Renewable Fuel and Vehicle Technology Program Reimbursable Budget Authority	$3 million BBL	Reimbursements	Approve the item but reject the BBL allowing the reimbursement authority to be increased by up to an additional $3 million.
	Department of Industrial Relations (7350)			
6	Child Performer Services Permits	$701,000 8 positions	Special Fund	Approve on two-year limited-term basis.

Vote:

7501 DEPARTMENT OF HUMAN RESOURCES
7503 STATE PERSONNEL BOARD

Department and Budget Overview – Department of Human Resources. The California Department of Human Resources (CalHR) is responsible for managing the state's personnel functions and represents the Governor as the "employer" in all matters concerning state employer-employee relations. CalHR is responsible for issues related to recruitment, selection, salaries, benefits, and position classification, as well as provides a variety of training and consultation services to state departments and local agencies. CalHR also sets salaries and benefits for employees excluded from collective bargaining and employees exempted from civil service.

	2011-12* (actual)	2012-13 (estimated)	2013-14 (proposed)
Expenditures	$66,302,000	$93,643,000	$92,901,000
General Fund	$6,101,000	$8,064,000	$7,162,000
Positions	187.4	297.8	278.5

*Prior to July 1, 2012, represents the former Department of Personnel Administration structure and budgetary resources.

Department and Budget Overview – State Personnel Board. The five-member State Personnel Board (SPB), whose members are appointed by the Governor for ten-year terms, was established in the California Constitution in 1934. The SPB is responsible for California's civil service system, ensuring it is free from political patronage and that employment decisions are based on merit.

	2011-12* (actual)	2012-13 (estimated)	2013-14 (proposed)
Expenditures	$25,614,000	$10,094,000	$10,434,000
General Fund	$2,907,000	$1,059,000	$1,104,000
Positions	169.1	69.7	69.7

Issue Proposed for Discussion / Vote

Issue 7: Additional Appointments of Exempt Employees

Background. In part, the 2011 Governor's Reorganization Plan No. 1 (GRP 1-2011) consolidated the human resource management functions and authorities previously vested with State Personnel Board (SPB) and Department of Personnel Administration, except for the constitutional responsibilities of SPB, into CalHR. The main goal of this aspect of the GRP 1-2011 was for state departments to have a single entity to offer guidance to non-merit personnel issues, while the SPB retained its autonomous constitutional authority over the interpretation of the civil service law and the merit-based system. Consistent with the GRP 1-2011, the SPB continues to act as an independent five-member Board independent of CalHR, appointed by the Governor and serving ten-year terms, to hear merit appeals and oversight of the merit principle. The SPB provides direction to departments through simplifying civil service laws, rules, and policy. Within its constitutional authority, the SPB audits departments for merit system compliance.

CalHR is also responsible for managing the state's personnel functions and represents the Governor as the "employer" in all matters concerning state employer-employee relations. CalHR is responsible for issues related to recruitment, selection, salaries, benefits, and position classification, as well as provides a variety of training and consultation services to state departments and local agencies.

The federal Fair Labor Standards Act (FLSA) establishes minimum wage, overtime pay, recordkeeping, and child labor standards affecting full-time and part-time workers in the private sector and in Federal, State, and local governments. State laws, rules, policies, and bargaining unit contracts govern most personnel and labor issues. CalHR uses Policy Memos (formerly called PMLs) to tell state departments and agencies about new policies, procedures, and to provide other important information.

Recent media reports have brought transparency to a state human resource practice common to eleven state departments whereby managers with a fixed salary also assumed a secondary rank-and-file position within the same department. Figure 1 below details the count of additional appointments as of January 11, 2013.

Figure 1 – Count of Unique Employees with Additional Positions within the Same Department – January 11, 2013

Department	Unique Employee Count
Corrections and Rehabilitation	227
Department of State Hospitals	173
Social Services	101
Public Employees' Retirement System	56
Employment Development Department	4
Education	2
Food and Agriculture	2
Motor Vehicles	2
Veterans Affairs	2
Consumer Affairs	1
Forestry and Fire Protection	1
Total	**571**

Source: State Controller's Office

On January 30, 2013, CalHR issued Policy Memo 2013-007 to prohibit departments from making any new additional appointments. CalHR is in the process of reviewing relevant laws, rules, and prior procedures that have been applied to additional appointments to date. CalHR further requested all departments report by February 15, 2013, details of their additional appointments. CalHR has begun a review of each additional appointment and indicates that it will take necessary and appropriate action on a case-by-case basis.

In response to questions from the Senate Budget and Fiscal Review Committee about what authority was utilized in making the additional appointments, the affected departments indicated that Section 350 of the Personnel Management Policy and Procedures Manual (PMPPM), dated January 1979, sets forth standards and guidelines surrounding eligibility for an additional appointment. Departments also point to Government Code Sections 19050-19237, as the statutes that deal with appointments.

Staff Comment. Current state law does not prohibit additional appointments. An additional appointment does not violate the FLSA. However, there are separate tests under the FLSA to ensure that the exempt status of the primary position is not compromised and to determine whether employees were compensated properly. Additional appointments are also not necessarily out of the norm as a human resources policy. For instance, at Stony Brook Medicine, the academic medical center affiliated with Stony Brook University, the State University of New York, "extra service/dual appointments" are utilized but under strict conditions. These conditions create an "arm's length" transaction, in that the additional position is in a different department or unit from the primary position, compensation for the additional appointment cannot be used in lieu of overtime for employees deemed eligible under the FLSA and cannot exceed 20 percent of the primary position annual salary, and approval for the additional appointment must be obtained prior to the start of the service.

From the responses received from affected departments, it does not appear that there is a consistent statewide policy as to the use of additional appointments. Rather, the use of additional appointments appears in many ways to be an "underground" human resources policy. A PMPPM from 1979, that has not been updated or available since 2000, is not a prudent basis upon which to make appointments to civil service. The lack of a clear, updated policy is effectively a non-policy, and creates an atmosphere ripe for abuse and misunderstanding.

Staff acknowledges that departments have made additional appointments for a variety of reasons, including workload, perhaps salary compaction, and could even be an impact of furloughs (data has been requested from the State Controller to examine this specific question). But the use of additional appointments calls into question broader topics such as budget transparency, concerns about jeopardizing the civil service merit principle, and legal concerns about FSLA violations. Additional appointments are also a test of the GRP 1-2011 as it pertains to the consolidation of day-to-day operational personnel management functions into CalHR, with the SPB providing objective, independent oversight of the merit system. These broader questions warrant consideration by the Subcommittee.

Subcommittee Questions. Based on the above comments, the Subcommittee may wish to ask the Administration and CalHR to respond to the following questions:

1. Will the SPB and/or CalHR take the lead to ensure consistent human resources policy application across state service, not just for additional appointments but for human resources policies generally?
2. Did all departments meet the February 15, 2013, reporting requirement to CalHR? If not, which department(s) remain(s) outstanding?
3. Does the CalHR review include rank-and-file additional appointments, which may be permissible under collective bargaining agreements?
4. How long will it take for CalHR to review existing additional appointments?
5. Does CalHR plan to report to the SPB and Administration its findings from the review of the existing additional appointments?
6. Is the Administration considering any potential solutions? At a minimum, should dual appointments be prohibited in the same department or the same unit?

Staff Recommendation: Hold this issue open pending receipt of further information.

7501 DEPARTMENT OF HUMAN RESOURCES

Department and Budget Overview – Department of Human Resources. The California Department of Human Resources (CalHR) is responsible for managing the state's personnel functions and represents the Governor as the "employer" in all matters concerning state employer-employee relations. CalHR is responsible for issues related to recruitment, selection, salaries, benefits, and position classification, as well as provides a variety of training and consultation services to state departments and local agencies. CalHR represents the Governor in collective bargaining with unions representing rank and file state employees and sets salaries and benefits for employees excluded from collective bargaining and employees exempted from civil service.

	2011-12* (actual)	2012-13 (estimated)	2013-14 (proposed)
Expenditures	$66,302,000	$93,643,000	$92,901,000
General Fund	$6,101,000	$8,064,000	$7,162,000
Positions	187.4	297.8	278.5

*Prior to July 1, 2012, represents the former Department of Personnel Administration structure and budgetary resources.

Issues Proposed for Discussion / Vote

Issue 8: Implementation of In-Home Supportive Services Employer-Employee Relations Act

Governor's Budget Request. The January budget requests $563,000 GF and four positions to implement Chapter 45, Statutes of 2012, a budget trailer bill pertaining to the In-Home Supportive Services (IHSS) Employer-Employee Relations Act.

On March 1, 2013, this request was revised by the Administration to instead propose the costs be split 50 percent GF and 50 percent Reimbursements (federal funds). The Department of Social Services would apply for and receive federal funds for 50 percent of the costs and transmit those dollars, as reimbursement, to CalHR. The revised proposal includes budget bill provisional language providing a GF "backstop" should the federal funds not materialize as projected and requires notification to the Joint Legislative Budget Committee should this "backstop" be utilized.

Background. The Budget Act of 2012 authorized the Coordinated Care Initiative, whereby persons eligible for both Medicare and Medi-Cal would receive medical, behavioral, long-term supports and services, and home- and community-based services coordinated through a single health plan in eight demonstration counties (Alameda, Los Angeles, Orange, Riverside, San Bernardino, San Diego, San Mateo, and Santa Clara). Chapter 45 contained the necessary statutory changes to implement the human services provisions related to the integration of services, including IHSS, into the CCI.

The IHSS program provides personal care services to approximately 420,000 qualified low-income individuals who are blind, aged (over 65), or who have disabilities. These services frequently help program recipients to avoid or delay more expensive and less desirable institutional care settings. County social workers determine IHSS eligibility and perform case

management after conducting a standardized in-home assessment of an individual's ability to perform activities of daily living. Based on authorized hours and services, IHSS recipients are responsible for hiring, firing, and directing their IHSS provider(s). In the vast majority of cases, recipients choose a relative to provide care.

In 2012, there were around 380,000 IHSS providers with hourly wages varying by county and ranging from $8.00 to $12.20 per hour. Prior to July 1, 2012, county public authorities or nonprofit consortia were designated as "employers of record" for collective bargaining purposes on a statewide basis, while the state administered payroll and benefits. Pursuant to Chapter 45, however, collective bargaining responsibilities in the eight counties participating in the Coordinated Care Initiative (CCI) will shift to an IHSS Authority administered by the state.

The scheduled phasing for the enrollment in CCI in the eight pilot counties has been delayed until September 2013, and the state has not yet developed a Memorandum of Understanding with the federal CMS to implement CCI. The Department of Health Care Services (DHCS) indicates that delay in timeline means that the first notices that any enrollees would receive about this transition would come no earlier than June 2013.

Statute requires that in the event DHCS has not received, by February 1, 2013, federal approval, or notification indicating pending approval, then effective March 1, 2013, the provisions of the dual demonstration project, enrollment of dual beneficiaries into Medi-Cal managed care, and long-term supports and services integration become inoperative. At the time of this agenda, the Legislature has not received notice of federal approval. Rather, on February 1, 2013, the Director of Centers for Medicare and Medicaid Services (CMS) sent a letter to DHCS indicating that "we have made significant progress," and that CMS "look[s] forward to finalizing the MOU in the near term and continuing to work in partnership toward a successful implementation beginning in September 2013."

This budget request assumes that in June 2014 collective bargaining responsibility will begin to transfer to the Statewide Authority and CalHR will be expected to bargain on behalf of the Statewide Authority. The Administration indicates that the four positions in this request will allow CalHR to begin to prepare a collective bargaining platform on behalf of the Statewide Authority, including examining current contracts, observing bargaining sessions, identifying bargaining complexities, building working relationships, and determining legal and health benefit complexities. These staff will also assess the resources needed to begin full implementation of this program in July 2014. Of the four positions, two are in the Labor Relations Division, one is in the Legal Division, and one is in the Benefits Division.

Staff Comment. Staff acknowledges that Chapter 45 presents new workload for CalHR and this workload is not absorbable within existing resources. However, many uncertainties remain as to the status of the CCI, as IHSS first has to come on-line as a Medi-Cal managed care benefit *prior* to the Statewide Authority being established for purposes of collective bargaining. The Administration reports that San Mateo County will be fully enrolled in September 2013; thus the Statewide Authority would be the employer and CalHR would be the designated collective bargaining representative for San Mateo County in September 2013. The remaining seven counties, with the exception of Los Angeles, will not be fully enrolled and transitioned until September 2014 at the earliest. However, this timing hinges on federal approval which has not yet been received. While the February 1, 2013, letter from CMS could be seen generally as notification of future pending approval, it is not clear upon which date that formal approval will be granted.

The Administration is working from the assumption that this program will become statewide and permanent. However, a separate budget trailer bill last year (Chapter 859) contained only intent language for that to be the case within three years of starting the demonstration. It will require further action of the Legislature to provide the actual statutory authority, as well as an appropriation, to expand the CCI beyond the eight pilot counties.

These considerations present a challenge for the Subcommittee in considering this request. At a minimum, staff cannot recommend any permanent resources at this juncture; given all the uncertainties, resources should only be approved on a limited-term basis. Further, the issue before this Subcommittee is a very small part of the much larger CCI which is in the jurisdiction of Subcommittee No. 3. As such, the Subcommittee may wish to delay action on this request until a later date to allow for further coordination and consultation with Subcommittee No. 3.

Staff Recommendation: Hold open pending further consultation with Subcommittee No. 3.

Issue 9: Salary Compaction

Background. Employees appointed to managerial and support positions by elected officials are not covered by the laws and rules of the California civil service and are referred to as "exempt" employees. Managerial and supervisorial employees and employees involved in employee/employer relations (called "confidential" employees) are excluded from collective bargaining rights and are referred to as "excluded" employees. Often, when an agreement or Memorandum of Understanding (MOU) is reached with a state bargaining unit for represented employees, certain provisions of the agreement or MOU are also extended to related classes of excluded employees. For example, if represented employees are given a salary increase of three percent that same increase is often extended to excluded employees in related classes.

Current law requires that CalHR set salaries for excluded and exempt employees, and allows excluded employee representatives to meet and confer with CalHR, but does not otherwise make the state employer or excluded employees subject to collective bargaining requirements. There is no statutory requirement to extend, to excluded employees, a pay package that was bargained for represented employees, or to study the impact of the MOU on related excluded classes. According to CalHR, they do not routinely do compaction studies upon reaching a MOU agreement, nor do they routinely include estimated costs or savings of extending MOU provisions to related excluded classes when submitting the MOU package to the Legislature and LAO.

LAO Comment. In prior analyses of the budget, the LAO has recommended that the Administration pay attention to manager and supervisor pay; compaction is a problem because it reduces incentives for employees to seek promotion to supervisory positions and it encourages supervisors to demote to highly paid rank-and-file positions.

Staff Comment. "Salary compaction" generally occurs when managerial employees do not earn enough in relation to the employees they supervise. Managerial employees do not generally receive overtime pay and other protections afforded to rank-and-file employees. Moreover, they may have higher levels of stress and responsibility. If managerial compensation is not high enough, employees may be disincentivized from seeking promotions or, after promoting, may later decide to demote to non-managerial positions.

The state has, in the past, had a policy of ensuring a five to ten percent salary spread between rank-and-file employees and supervisors and managers. Many believe that ten percent is a minimum that managers and supervisors should earn above those employees they manage. Without this pay spread, supervisors and managers are often working longer hours, taking on greater responsibilities, and assuming higher stress levels for less pay than those they supervise due to the fact that they do not receive overtime pay like rank-and-file workers.

Subcommittee Questions. Based on the above information, the Subcommittee may wish to ask CalHR to respond to the following questions:

1. The lack of adequate pay for managers and supervisors has caused some capable managers to demote to non-managerial positions and encouraged others to forgo

promotion. How is CalHR monitoring salary compaction, and how pervasive is this problem? What is CalHR doing to address this issue?

2. In which departments and employee classifications are salary compaction issues more prevalent?
3. How does overtime play into this issue; i.e., is compaction more of an issue in departments where rank-and-file employees work a lot of overtime (such as in state prisons and hospitals) and/or where managers oversee mixed groups of employees?

Staff Recommendation: This is an informational item.

7900 PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Issue and Budget Overview. The Legislature determines policies concerning state employee, both active and retired, health benefit programs. Through the Public Employees' Medical and Hospital Care Act (PEMHCA), the Legislature vests responsibility for managing health care programs for state workers, state retirees, and employees or retirees of participating local agencies with the California Public Employees' Retirement System (CalPERS). The state's contribution to employee health care is based on a negotiated percentage of the average cost of four health plans with the most enrolled state employees. Any health premium increases in a calendar year are negotiated by CalPERS with health plan providers; the CalPERS board typically adopts the next year's health premiums in June. The cost of state employer health and dental care benefits for active employees and retirees, and their dependents, is estimated to total $2.9 billion GF ($1.2 billion other funds) in 2013-14. This represents a year-to-year increase of $322 million GF ($59 million other funds) over the 2012-13 expenditure level, reflecting an estimated 8.5 percent increase in health premium rates.

Issue Proposed for Discussion / Vote

Issue 10: Administration of Health Benefits Programs for State Active Employees and Retirees

Background. Existing budget bill provisional language encourages the CalPERS Board of Administration to use the means at its disposal under the law, consistent with requirements to provide benefits to public employees and others, to achieve low annual premium increases. CalPERS is required to annually report to the Legislature within 100 days of the adoption of annual health premium increases or decreases the methods it employed to moderate annual increases in premiums when taking that action.

In its September 2012 report to the Legislature, CalPERS reported that it expanded previously successful programs, such as the High Performance Provider Networks and the Blue Shield Medicare Advantage program, to achieve 2013 rate year savings of $16 million, and pharmacy benefit modifications are estimated to achieve additional 2013 rate year savings of $54 million. CalPERS also reported on future plans to reduce premium increases, including continued work to develop and implement 21 health initiatives adopted by the Board of Administration in January 2012. Included in the 21 initiatives was "risk adjustment" which is an actuarial tool used to calibrate payments to health plans based on the relative risk of the population. Risk adjustment required changes to both statutory and regulatory authority. The statutory authority was enacted in Chapter 445, Statutes of 2012; the CalPERS Board adopted the regulatory changes at its February 2013 meeting. CalPERS reports that risk adjustment will be implemented in the 2014 plan year.

CalPERS is also pursuing a family member eligibility verification review for health benefits coverage to ensure only those dependents eligible for coverage by state health benefits are, in fact, enrolled in state-funded plans. CalPERS estimates that four to six percent of current enrollees (roughly 29,000) are not eligible, which would result in full year savings of an estimated $40 million. CalPERS instituted a three-month amnesty period, allowing employees to proactively remove ineligible individuals between April 1 and June 30 of this

year without penalty. Amnesty is proven to encourage voluntary disenrollment because employees and annuitants could otherwise be liable for prior health claims and employer contributions for premiums during the period of ineligibility. Beginning on July 1, 2013, CalPERS will begin a systematic review of all dependent enrollees and it will take until the end of calendar year 2014 to complete the review. If an enrollee is unable to validate eligibility for a dependent, the dependent will be disenrolled.

Staff Comment. All parties are concerned about the increases in health care costs, as they present a budgetary challenge not only for the state but also for local governments and private employers. As evidenced by the September 2012 report, including the continued implementation of the 21 initiatives intended to reduce future premium increases, and the family member eligibility verification review, CalPERS continues to work on multiple fronts to achieve savings in the Health Benefits Program. However, even with these extensive efforts, overall program costs continue to grow, presenting continuing challenges to CalPERS in its administration of PEMHCA health care programs and for the State in managing its overall budget.

Subcommittee Questions. Based on the above comments, the Subcommittee may wish to ask CalPERS to respond to the following questions:

1. What does CalPERS foresee will be the impact(s) of “risk adjustment” on the health plans CalPERS administers, from both the perspective of the employer and the plan enrollee? Why is risk adjustment not implemented until the 2014 plan year?
2. What is the timeline for the 2014 procurement? How many providers have responded to the Request for Proposal for the HMO and PPO plans?
3. In 2011-12, CalPERS hired an additional employee to work on converting Medicare-eligible members from the Kaiser Basic Plan to a Kaiser Supplemental Medicare Plan. This voluntary campaign to convert members resulted in savings of $834,000 as reported to the Board in February 2013. What other efforts are underway to transfer Medicare-eligible retirees out of Basic plans?
4. What other initiatives are underway to address escalating health premium costs? Are these initiatives on-going or one-time in nature or a combination thereof?
5. CalPERS is the largest employer purchaser of health benefits in California and the second largest employer purchaser in the nation after the federal government. How, and in what specific ways, does CalPERS utilize its significant market share to benefit both the state (as the employer and payor) and plan enrollees?

Staff Recommendation: This is an informational item.

CS 3.60 CONTRIBUTION TO PUBLIC EMPLOYEES' RETIREMENT BENEFITS

Issue and Budget Overview. Control Section 3.60 provides the mechanism for increases and decreases regarding the state's employer contribution to public employee retirement accounts, based on the determination of required funding levels. The control section holds department budgets harmless in the event of increases in employer CalPERS contribution rates and achieve budgetary benefit for the state when CalPERS contribution rates decline.

Issue Proposed for Discussion / Vote

Issue 11: Employer Pension Contribution Savings Directed to State's Unfunded Pension Liability

Governor's Budget Request. The January budget increases by $48.7 million GF ($46.5 million other funds) for the state's employer pension contribution. Included in the total is $42.2 million GF ($21 million other funds) directed at the state's unfunded pension liability to reflect the savings resulting from increased employee contributions under Chapter 296, Statutes of 2012 (Assembly Bill 340), Public Employees' Pension Reform Act of 2012.

Background. Chapter 296 enacted major revisions to the public retirement systems' laws in California, including for CalPERS. One of the major revisions was the adoption of a standard for employees to pay 50 percent of the normal cost and for employers not to pay the employee contribution. Chapter 296 therefore allowed for the adjustment of the employee contribution for legacy state employees in selected bargaining units (and related exempt and excluded employees) that were not at the 50 percent share of the normal cost standard. These bargaining units are primarily in the safety arena and Chapter 296 allowed for a multi-year phase-in of the increased employee contributions. The first increases are effective July 1, 2013. Chapter 296 requires any savings in employer contributions from increased employee contributions be directed to the state's unfunded pension liability, subject to appropriation in the annual budget act.

Staff Comment. Prior to the adoption of Chapter 296, generally any increased employee pension contributions offset the employer's contribution. Chapter 296 now directs any such savings to the state's unfunded pension liability subject to appropriation in the annual budget act. The Governor's January budget states that the CalPERS unfunded retirement liability is $38.5 billion.

Staff Recommendation: Approve the budget request.

Vote:

7100 EMPLOYMENT DEVELOPMENT DEPARTMENT

Department and Budget Overview. The Employment Development Department (EDD) administers services to employers, employees, and job seekers. The EDD pays benefits to eligible workers who become unemployed or disabled, collects payroll taxes, administers the Paid Family Leave Program, and assists job seekers by providing employment and training programs under the federal Workforce Investment Act of 1998. In addition, the EDD collects and provides comprehensive labor market information concerning California's workforce.

	2011-12 (actual)	2012-13 (estimated)	2013-14 (proposed)
Expenditures	$22,650,399	$20,285,428	$16,888,151
General Fund	$344,217	$329,875	$313,314
Positions	9,386.4	9,696.1	8,932.4

Dollars in Thousands.

Issues Proposed for Discussion / Vote

Issue 12: Unemployment Insurance Loan Interest Payment

Governor's Budget Request. The January budget requests $291.2 million GF to pay the third interest payment due to the federal government for the quarterly loans the EDD has been obtaining from the federal government since January 2009 to cover the Unemployment Insurance (UI) Fund deficit and make payment to UI claimants without interruption.

The January budget does not include a proposal to repay all or part of the 2011 and 2012 loans, totaling $611.7 million, made from the Unemployment Compensation Disability Fund (DI) to the GF to make the required federal interest payments. The January budget is also silent on how to fund future interest payments for funds borrowed from the federal government to pay UI benefits and a proposed solution to address the insolvency of the UI Fund. The Administration indicates that proposals will be developed to address all three of these problems during a series of stakeholder meetings convened by the Secretary of the Labor and Workforce Development Agency that began in February 2013.

Background. The UI program is a federal-state program, authorized in federal law but with broad discretion for states to set benefit and employer contribution levels. The UI program provides weekly payments to eligible workers who lose their jobs through no fault of their own. Benefits range from $40 to $450 per week for up to 26 weeks (additional weeks available due to federally-funded extensions), depending on earnings in a 12-month base period. The program is financed by unemployment tax contributions paid by employers, based on the number of employees, on the first $7,000 of taxable wages paid to each employee. The contribution schedule is comprised of seven schedules, ranging from AA to F, with a range of 0.1 percent (the lowest rate on Schedule AA) to 6.2 percent (the maximum rate on Schedule F). Current law also includes a provision to add a 15 percent emergency solvency surcharge when the UI fund reserve is low (Schedule F+). California employers have been on this emergency F+ schedule since calendar year 2004.

The UI Trust Fund (UI fund) became insolvent in January 2009 and ended that year with a shortfall of $6.2 billion. The contributing factors to the insolvency of the UI fund are: (1) significant statutory increases to the UI benefit level that began in 2002 – these legislative changes increased the maximum weekly benefit amount from $230 per week to $450 per week; (2) no change in the UI financing structure despite significant increases to UI benefits – for example, the taxable wage ceiling has remained at the federal minimum level of $7,000 since 1983; (3) the inability of the fund to build a healthy reserve in the last decade – the EDD indicates that the existing UI financing system can be sustained in the long run only if the state unemployment rate averaged around four percent over time; and (4) the current economy which resulted in increased UI benefit payments and decreased revenues.

With the UI fund insolvent, the state began borrowing funds from the Federal Unemployment Account in order to continue paying UI benefits without interruption. The UI fund deficit was $9.9 billion at the end of 2011 and is expected to increase to $10.2 billion at the end of 2013. Generally, loans lasting more than one year require interest payments; the federal American Recovery and Reinvestment Act (ARRA) of 2009 provided temporary relief to states from making interest payments on UI loans through December 31, 2010. With the expiration of the ARRA provisions, interest of $303.5 million was paid in September 2011 and interest of $308.2 million was paid in September 2012. Interest will continue to accrue and be payable annually until the principal on the federal UI loan is repaid. Federal law requires that the interest payment come from state funds. Due to the condition of the GF, both the 2011 and 2012 interest payments were made by borrowing funds from the DI Fund. Under current law, the 2011 and 2012 loans are to be repaid from the GF to the DI Fund by June 30, 2016, and June 30, 2017, respectively.

Federal law also includes provisions to ensure that a state does not continue to incur loans over an extended period. Specifically, if a state has an outstanding loan balance on January 1 for two consecutive years, the full amount of the loan must be repaid before November of the second year or employers face higher federal UI taxes. The full federal unemployment insurance tax rate is six percent. Employers receive a 5.4 percent credit (Federal Unemployment Tax Act, or FUTA, Credit Reduction), resulting in an effective tax rate of 0.6 percent on the first $7,000 of earnings per employee on an annual basis, or $42 per employee. Due to California carrying an outstanding loan balance for two consecutive years, the FUTA credit reduction began decreasing in calendar year 2011, resulting in increased employer costs in calendar year 2012. Each year that the loans remain outstanding, the FUTA credits will continue to decrease by 0.3 percent, resulting in dramatically increasing costs for employers, as displayed in Figure 2 below. These additional federal taxes pay down the principal on the federal loan. Absent any corrective action, the Administration projects that the federal loan will not be fully repaid until sometime after 2020.

Figure 2 – Federal Unemployment Tax Act Credit Reduction

	2012*	**2013***	**2014***	**2015***
Tax Rate	1.2%	1.5%	1.8%	2.1%
Estimated Additional Tax Collections Resulting from the FUTA Credit Reduction per Employee	$24.00	$48.00	$72.00	$100.00
Estimated Additional Tax Collections Resulting from FUTA Credit Reduction	$290 million	$582 million	$894 million	$1.2 billion

*Calendar Year.

Staff Comment. The January budget estimated a federal interest rate of 2.9430 percent, resulting in the payment amount of $291.2 million. The federal Department of Labor has since announced that the 2013 interest rate is 2.5765 percent. Consistent with prior years, the Administration plans to update the estimated interest payment amount in the spring based on the new interest rate and the May 2013 Unemployment Insurance Fund Forecast which estimates UI revenue and payments.

Similar to language contained in the 2011 Budget Act, this request is accompanied by budget bill provisional language that authorizes the Department of Finance to increase/decrease the actual amount paid/borrowed from the GF fund based on a more precise calculation of the estimated UI revenue and payments.

In considering this request, the Subcommittee may wish to request an update from the Administration as to the status of the stakeholder process to address the state's outstanding UI-related issues, as well as information as to the estimated timing when a formal proposal to restore solvency to the UI Fund might be finalized.

Staff Recommendation: Approve the budget request.

Vote:

7350 DEPARTMENT OF INDUSTRIAL RELATIONS

Department and Budget Overview. The objective of the Department of Industrial Relations (DIR) is to protect the workforce in California; improve working conditions; and advance opportunities for profitable employment. The DIR enforces workers' compensation insurance laws and adjudicates workers' compensation insurance claims; works to prevent industrial injuries and deaths; promulgates and enforces laws relating to wages, hours, and conditions of employment; promotes apprenticeship and other on-the-job training; assists in negotiations with parties in dispute when a work stoppage is threatened; and analyzes and disseminates statistics which measure the condition of labor in the state.

	2011-12 (actual)	2012-13 (estimated)	2013-14 (proposed)
Expenditures	$391,107,000	$412,471,000	$586,119,000
General Fund	$4,321,000	$2,385,000	$2,468,000
Positions	2,378.8	2,706.6	2,796.6

Issues Proposed for Discussion / Vote

Issue 13: Implementation of Workers Compensation Reform

Governor's Budget Request. The January budget requests $152.9 million and 82 positions, and $146.5 million ongoing, from the Workers' Compensation Revolving Fund (including $13 million in reimbursement authority) to implement Chapter 363, Statutes of 2012, which enacted comprehensive reforms to the state's workers' compensation system.

Background. California's workers' compensation system was established in 1913 and provides exclusive remedy for industrial injuries, irrespective of the fault of the employee or employer. All employers in California, except the state, must secure payment of workers' compensation insurance through the purchase of an insurance policy or obtaining a certificate of self-insurance with DIR's Office of Self Insurance Plans. Injured workers receive medical treatment without cost, as well as a variety of benefits to compensate for injuries arising out of, and in the course of, employment. These benefits include: temporary disability indemnity (weekly benefits paid during time lost from work); permanent disability indemnity (weekly benefits paid to compensate the injured employee's permanent impairment that affects his/her ability to compete in the open labor market); supplemental job displacement benefit (to provide a voucher for the retraining of those injured workers who are unable to return to their usual employment as a result of the injury); and death benefits (to compensate total and partial dependents of a worker who dies as the result of an industrial injury).

The DIR's Division of Workers' Compensation is the lead agency that oversees the administration of workers' compensation benefits to over 500,000 Californians who are injured on the job each year. One of the DWC's core responsibilities is the administration of California's exclusive judicial system for resolution of work injury claims.

Fundamentally, workers' compensation is an agreement between employers and employees to each give up a right in exchange for the stability and certainty of the workers' compensation system. Over the years, the principles of relatively certain benefits and relatively timely delivery have been seriously eroded. Inconsistency in parties' abilities to ascertain exactly what benefits an injured worker is entitled to have forced the system to develop a complex, cumbersome, and slow litigation-based dispute resolution system.

Chapter 363 was enacted to comprehensively reform the system and return to the principles of relatively certain defined benefits and relatively timely delivery of those benefits. Chapter 363 made changes to: the measurement of permanent disability; the compensation for permanent disability; the process for resolving disputes over appropriate medical treatment; medical fees, billing, and collections; taking steps to ensure self-insurance program solvency and the methods of securing the payment of compensation by self-insurance; and other aspects of the workers' compensation system. Each of the components of Chapter 363 drive program changes and/or requirements that inherently creates a need to capture, integrate, and/or manage data in a more effective manner. The resources included in this request are as follows:

1. *Special Earnings Loss Supplement Program (referred to in Chapter 363 as a "return-to-work" program).* $125 million, including $120 million as stipulated in Chapter 363 to pay annual claims for supplemental payments to injured workers whose permanent disability benefits are disproportionately low in comparison to their earnings loss. A study has been commissioned to assess the program's eligibility requirements. The remaining $5 million is for program administration and to support 27.5 positions.

2. *Division of Workers' Compensation*. $25.3 million and 36.5 positions to administer the following: Independent Medical Review; Lien Filing Review/Process Program; Interpreter Certification Program; Medical Provider Network; Resource Based Relative Value Scale (RBRVS) adoption; and additional Workers' Compensation Appeals Board workload.

3. *Office of Self Insurance Plans (OISP).* $2.4 million and six positions to improve the oversight capacity of the OISP to evaluate the costs of administration, workers' compensation benefit expenditures, and solvency and performance of public self-insured employer workers' compensation programs.

4. *Division of Administration*. $1.5 million and 12 positions for general administrative support staff workload in accounting, business management, and human resources.

5. *Additional Studies*. $317,000 in 2013-14, and $217,000 in 2014-15, to conduct the following studies: provisions in the event of insolvencies for public workers' compensation programs, as well as the evaluation requirements of OSIP listed above; the average loss earnings of employees with a permanent disability rating under the schedule; and a study on high quality medical care in the workers' compensation system.

The January budget also includes budget bill provisional language that would allow the Administration, subject to Department of Finance approval and legislative notification, to increase funding for the RTW program to pay claims that exceeded the $120 million appropriation in Chapter 363.

LAO Analysis. With regard to the Return to Work (RTW) program, the Administration's proposed budget bill language would potentially broaden the scope of the program beyond that intended by the Legislature and create a potentially larger funding obligation than was provided in Chapter 363. Until DIR adopts regulations establishing program eligibility and benefit levels, it is difficult to determine what level of funding would be necessary to fund eligible injured workers pursuant to DIR's program guidelines. The Administration's proposed program model may conflict with the $120 million RTW program specified in Chapter 363. Instead of studying eligibility requirements and developing benefit levels that could be sustained by the funding provided in Chapter 363, the Administration is requesting broader funding authority. Because the Administration has not yet developed the eligibility requirements and benefit levels for the RTW program, the LAO is unable to estimate the potential financial obligation, and the corresponding increase in workers' compensation employer assessments, for the RTW under the Administration's proposal.

LAO Recommendation. The Legislature should clarify its intent in funding the RTW program created by Chapter 363. If the Legislature intended for a capped program allocation of $120 million annually, the Legislature should reject the Administration's proposed budget bill language, and instruct DIR to develop program eligibility and benefit levels consistent with the appropriation level provided in Chapter 363. Consistent with this action, the Legislature should reduce DIR's expenditure authority in the Workers' Compensation Administration Revolving Fund by $5 million in 2013-14 (and reject the related request for 23 positions) to reduce the RTW program's budget to the $120 million appropriation provided by Chapter 363.

Alternatively, if the Legislature did not intend for a $120 million annual cap on the RTW program, then the Legislature will need to evaluate whether it wants to cede some of its oversight during the annual budget process by allowing midyear budget augmentations, with more limited legislative review, as proposed by the budget bill language. Also, if the Legislature did not intend for a $120 million annual cap on the RTW program, then there is no issue with the $5 million additional funding proposed in the 2013-14 budget for program operations.

Staff Comment. Staff finds no issues with the overall resources requested to implement Chapter 363. The implementation of Chapter 363, and within the timelines specified in the bill, is an immense task for the DIR. It logically follows that new resources will be needed.

With regard to the RTW program, staff understands that the Legislature intended $120 million per year to fund this program. Any administration costs would be additive. While the Administration's proposed budget bill provisional language addresses the scenario of "what if the $120 million is insufficient to pay all eligible claims," an equally legitimate question can be raised about the reverse; i.e., "what happens if claims total less than the funding available?" The Administration has indicated that if claims should total less than the funding available in a given year, this will result in an increased balance in the fund which will offset (reduce dollar for dollar) the next year's assessment consistent with the existing assessment authority. Given that this program was effective with the enactment of the bill on January 1, 2013, it does not appear likely that the entire $120 million will be claimed in year one of the program. Rather, it is far more likely that less than $120 million will be claimed in year one of the program. Another outstanding question about the RTW program is clarity about the effective date. As stated above, staff understands that the legislative intent was to make the fund available for injuries that occur on or after January 1, 2013. In considering this request,

the Subcommittee may wish to reinforce and clarify both of these issues related to the implementation of Chapter 363.

Staff Recommendation: Approve the request, modified as follows: (1) reject the budget bill language that would allow the Administration to increase funding for the RTW program to pay claims that exceeded the $120 million appropriation in Chapter 363; and (2) adopt placeholder budget trailer bill language to clarify that any unexpended RTW funds are added to the following year appropriation and reinforce that the effective date of the RTW program is January 1, 2013.

Vote:

Issue 14: Cal/OSHA Program, Enforcement of Workplace Safety and Health Standards

Background. The Division of Occupational Safety and Health (Cal/OSHA) is responsible for enforcing occupational safety and health standards, investigating occupational injuries, and inspecting and permitting elevators, amusement rides, and passenger tramways. Funding for Cal/OSHA has historically come from the General Fund, several special funds, and federal funds. Since 2009, Cal/OSHA no longer receives GF support (except for $431,000 in support of a federally matched injury and illness program). As part of the Budget Act of 2009, GF was replaced with revenue from the Occupational Safety and Health (OSH) Fund, which is an employer assessment on an employer's total workers' compensation insurance premium or on total "indemnity" (workers' compensation losses) for self-insured employers. OSH funding represents roughly 60 percent of the total funding for Cal/OSHA, with the remaining percentage funded by the Targeted Inspection and Consultation Fund and federal OSHA dollars.

Cal/OSHA staffing levels have remained fairly constant since 2009, although they reflect several across the board workload (staffing) reductions between 2009 and 2012 and as required by the Administration, including, but not limited to, the reduction of "salary savings" or "vacant" positions, which could not be filled in any case. The same can be stated about staffing in the Process Safety Management (PSM) Unit within Cal/OSHA, whose purpose is preventing or minimizing the consequences of catastrophic releases of toxic, flammable, or explosive chemicals (Labor Code Sections 7855-7870). Figure 3 on the next page displays Cal/OSHA filled positions from June 30, 2009, until June 30, 2012.

Figure 3 – Call/OSHA Staffing Levels 2009-2012

	6/30/2009	6/30/2010	6/30/2011	6/30/2012
Cal/OSHA Positions				
Regional Manager	5	5	5	5
District Manager	22	20	20	17
Field Staff	170	179	171	164
Senior SE (Ind)	8	11	11	11
Field Staff	13	13	10	8
Senior SE (M&T)	4	3	4	4
Prin SE (M&T)	1	1	1	1
PSM Staffing (subset of Cal/OSHA positions)				
Field Staff	10	10	10	9*
District Manager	2	2	2	1

"SE" is Safety Engineer; "Ind" is Industrial; and "M&T" is mining and tunneling.
*Currently, the number of Field Staff, or inspectors, in the PSM unit is 7.

The PSM unit enforces "process safety management" procedures that have broad applicability to potentially hazardous processes that exist in a wide variety of industries, although the primary focus is on the chemical and allied products industry and on the petroleum refining and related industries. These regulations require these industries to implement a comprehensive safety plan that includes a precise determination of what hazards exist and procedures to eliminate or reduce them. Employers must ensure that machinery and equipment are in good condition, that work procedures are safe, that hazards

are controlled, and that workers are trained to safely operate the equipment, recognize hazards, and respond appropriately in emergency situations.

Based on data the PSM unit gathers from its own research and from other agencies, a programmed Program Quality Verification (PQV) inspection is scheduled typically for one particular unit or process within a refinery and one element of the PSM regulations for each of the fifteen refineries in California each year. Given resource constraints, these PQV inspections are not “wall-to-wall” comprehensive inspections.

The LAO reported in February 2013 that employer assessments are an appropriate funding mechanism for Cal/OSHA on a policy basis because it is appropriate for the costs of regulatory activities to be paid for by the regulated community that creates the societal need for the regulation and benefits from the regulation (such as being issued a permit to operate a business). For most state programs, it has been the policy of the Legislature to fund regulatory activities from fees.

Staff Comment. On August 6, 2012, a fire broke out at Chevron Richmond refinery when a severely corroded pipe in the refinery’s #4 Crude Unit began leaking. Chevron managers did not shut down the unit but instructed workers to remove insulation, which led to the pipe’s rupture and a massive fire. While there were no serious worker injuries, a reported 15,000 residents of surrounding communities sought treatment after breathing emissions from the fire.

Cal/OSHA immediately began an investigation into the fire and the leak repair procedures. In findings released in January 2013, Cal/OSHA found that Chevron did not follow the recommendations, dating back to 2002, of its own inspectors and metallurgical scientists to replace the corroded pipe that ultimately ruptured and caused the fire. Chevron also did not follow its own emergency shutdown procedures when the leak was identified, and did not protect its employees and employees of Brand Scaffolding who were working at the leak site.

Also in January 2013, Cal/OSHA issued close to $1 million in fines against Chevron, the biggest penalty in the department's history and the maximum allowable under current law, for failing to replace the corroded pipe, not implementing its own emergency procedures, and violating leak-repair procedures. Cal/OSHA issued 25 citations against Chevron, 23 of which were classified as “serious” due to the realistic possibility of worker injuries and deaths in the fire. Eleven of these serious violations were also classified as “willful” because Cal/OSHA found Chevron did not take reasonable actions to eliminate refinery conditions that it knew posed hazards to employees, and because it intentionally and knowingly failed to comply with state safety standards.

Cal/OSHA has ongoing investigations for Chevron at its El Segundo refinery in the Los Angeles area and its oilfield in Lost Hills near Bakersfield.

The issue before the Subcommittee is not the Chevron Richmond refinery per se, but rather broader questions about the Cal/OSHA program and the degree to which the existing enforcement and inspection process and program is adequate to ensure workplace health and safety, particularly with regard to the PSM unit.

Subcommittee Questions. Based on the above comments, the Subcommittee may wish to ask DIR to respond to the following questions:

1. Given that DIR determined that Chevron did not follow the recommendations, dating back to 2002, of its own inspectors and scientists to replace the corroded pipe that ultimately ruptured and caused the fire, this raises several questions about the PSM unit:
   a. Should the PSM unit inspection process/schedule have identified the corroded pipe at the center of the recent refinery fire?
   b. Could a wall-to-wall inspection, which is not currently possible due to existing resource constraints, have identified the corroded pipe and prevented the refinery fire?
2. Is the PSM unit staffed adequately for the number of refineries in the state?
3. What is the amount of staffing hours that were consumed by the Richmond Refinery fire? What does that translate to as a percentage of the annual PSM unit budget?
4. From a historical standpoint, have there been any recruitment and/or retention issues with Cal/OSHA staffing?
5. Has DIR promulgated regulations under Labor Code Section 7870?
6. Has DIR considered assessing an additional fee on oil refineries to fund additional staff/inspections in the PSM unit?

Staff Recommendation. Direct subcommittee staff to continue to work with the Administration on identifying possible improvements to the Cal/OSHA program. As an interim step, and as part of the next issue on this agenda, consider redirecting $350,000 and four positions that are currently attached to workload associated with the High Hazard program to the Cal/OSHA program.

Issue 15: Regulatory Assessment Related Budget Proposals

Governor's Budget Request. In three separate but inter-connected proposals, related to DIR regulatory assessments in support of existing enforcement and compliance workload in occupational health and safety and labor standards, the January budget requests the following:

1. Budget trailer bill language to eliminate the sunset date and increase the annual revenue caps for the Occupational Safety and Health Fund (OSHF) and Labor Enforcement and Compliance Fund (LECF) assessments, from $52 million to $57 million and from $37 million to $46 million, respectively. These increases (in part) will backfill existing DIR Prevailing Wage Determinations ($2 million) and Injury and Illness Prevention ($431,000) programs whose GF will be permanently redirected to support the Compliance Monitoring Unit.
2. Budget trailer bill language to suspend collection of the high hazard assessment in years that the OSHF assessment is collected.
3. One-time loan of $5 million from the Targeted Inspection and Consultation Fund (TICF) for support of Compliance Monitoring Unit (CMU) operations. Further support the CMU with: (a) permanent redirection of $2.4 million GF internally from existing DIR programs; and (b) the adoption of budget trailer bill language to authorize DIR to recoup CMU enforcement costs that exceed the existing 0.25 percent cap on bond proceeds on CMU fees by requiring awarding bodies to reimburse the CMU using "other funding sources tied to the project." The trailer bill also removes the 0.25 percent cap on total project costs for projects that were not state bond-funded.
4. Budget trailer bill language to eliminate TICF funding for Cal/OSHA and backfill this funding with an offsetting OSHF assessment increase.
5. Budget trailer bill language to shift civil penalties that were previously deposited into the Construction Industry Enforcement Fund to the LECF.

Background. The Division of Occupational Safety and Health (Cal/OSHA) is responsible for enforcing occupational safety and health standards, investigating occupational injuries, and inspecting and permitting elevators, amusement rides, and passenger tramways. Funding for Cal/OSHA has historically come from the GF, several special funds, and federal funds. One special fund source for Cal/OSHA, the TICF, is supported by a special assessment on high hazard employers. TICF funds are used for workplace inspections and safety consultation services for high hazard employers. Cal/OSHA is also supported by the OSHF, which is an employer assessment on an employer's total workers' compensation insurance premium or on total "indemnity" (workers' compensation losses) for self-insured employers.

The Division of Labor Standards Enforcement (DLSE) enforces labor laws and investigates employers for issues related to wages, work hours, prevailing wage on public works projects, and discriminatory retaliation in the workplace. Similar to Cal/OSHA, funding for DLSE has historically come from GF, special fund, and federal fund sources.

In 2008-09, about $24 million of Cal/OSHA's operations and $38 million of DLSE's operations were funded by the GF. The 2009-10 budget eliminated GF support for Cal/OSHA and increased the assessment and funding in the OSHF to offset the GF reduction. The 2009-10 budget package also created an assessment on all employers, for deposit in the newly created LECF, to pay for DLSE costs formerly funded from the GF. GF support for DLSE

was reduced to $19.6 million in 2009-10 and eliminated entirely in 2010-11 through increased LECF assessments. Both the OSHF and LECF assessments are subject to an annual cap on total revenue collections and a sunset date of July 1, 2013.

Chapter 7, Statutes of 2009-10 of the Second Extraordinary Session, established the Compliance Monitoring Unit (CMU) within DIR to enforce prevailing wage requirements on specific public works projects as a replacement for enforcement through third-party Labor Compliance Programs. Chapter 7 also authorized DIR to charge a fee not to exceed 0.25 percent of state fond funds allocated to a project for CMU operations. To begin program operation, the CMU received a $1.3 million GF loan in 2009-10. However, program operation for the CMU was ultimately delayed until 2011 due in part to legal issues related to using state bond funding for CMU enforcement. Chapter 378 (2011) was enacted to ensure that money spent on monitoring and enforcement of a project is only paid with proceeds from that particular project. However, the nature of bond funding requires that CMU program expenses may only be charged in arrears, and may not exceed actual expenses incurred. Therefore, in addition to the 2009-10 GF loan, the CMU received a special fund loan in 2011-12 and the Budget Act of 2012 instituted a cash flow loan on an annual on-going basis to allow the CMU to operate and fulfill its statutory mandate.

DIR reports that this approach still does not address a fundamental flaw with the CMU funding structure: (1) exclusive dependence on restrictive bond funding; and (2) an arbitrary spending cap of 0.25 percent of the state bond proceeds for each project developed without regard to the level of enforcement needed in the aggregate, or on a project-by-project basis. The 2013-14 budget proposal is a combination of a one-time $5 million loan from the TICF, permanent funding redirections totaling $2.4 million GF, as well as budget trailer bill language to authorize DIR to recoup CMU enforcement costs that exceed the existing cap on bond proceeds on CMU fees by requiring local awarding bodies to reimburse the CMU using "other funding sources tied to the project." The legislation would also remove the 0.25 percent cap on total costs for projects that were no state bond-funded. This proposal is intended to provide a stable funding mechanism for the CMU.

LAO Analysis. The OSHF and LECF assessments pay for what would otherwise be GF costs in Cal/OSHA and DLSE. Employer assessments are an appropriate funding mechanism for Cal/OSHA and DLSE on a policy basis because it is appropriate for the costs of regulatory activities to be paid for by the regulated community that creates the societal need for the regulation and benefits from the regulation (such as being issued a permit to operate a business). For most state programs, it has been the policy of the Legislature to fund regulatory activities from fees. If the Legislature does not reauthorize the OSH and LECF assessments, there would be an approximate $80 million GF cost pressure in 2013-14 and ongoing.

High hazard employers currently pay both the high hazard and OSHF assessments. The Administration proposes a statutory change to suspend the high hazard assessment during a period when the OSHF assessment is being collected. The Administration states this will simplify the assessment process for occupational safety and health operations and eliminate the "double billing" of high hazard employers. The Administration's proposal creates greater efficiency in the assessment process, although the proposal has the effect of decreasing assessments on high hazard employers and increasing assessments for all other employers because suspending the high hazard assessment would be accompanied by a commensurate increase in the OSHF assessment (to make the proposal revenue neutral). However, high hazard employers would continue to pay higher assessments than less

hazardous employers under the Administration's proposal because OSHF assessments are calculated based upon an employer's workers' compensation premium or total indemnity, and high hazard employers would typically have higher premiums or indemnities.

The January budget estimates a $13 million fund balance in the TICF (which is net of the $5 million proposed loan for the CMU). Because of the existing fund balance, there is no budgetary need to eliminate TICF funding for Cal/OSHA and backfill the eliminated funding with an increased OSHF assessment in 2013-14 as the Administration proposes. TICF funding for Cal/OSHA could continue at its historical level of approximately $9 million in 2013-14.

The January budget proposes permanent solutions for the CMU, including a total shift of $2.4 million GF from other DIR programs to permanently fund the CMU. The proposed $431,000 GF redirection from Cal/OSHA's injury and illness statistics program to the CMU, and the corresponding funding backfill to Cal/OSHA through increased OSHF fees and expenditure authority, is an appropriate way to provide some base funding for the CMU. Cal/OSHA's injury and illness statistics program is a regulatory program affecting employers at large, and thus the program could be appropriately funded through the OSHF (which receives fee revenue from all employers for regulatory functions related to occupational safety).

In contrast to the Cal/OSHA redirection, the proposed $2 million GF redirection from general prevailing wage activities to the CMU, and the corresponding backfill of the redirected funding through increased LECF fees, raises policy concerns. The Governor is proposing to backfill funding for prevailing wage enforcement, which affects a small subset of the state's employers, with a general fee on all employers (the LECF fee). In this case, there appears to be an insufficient nexus between fee payer and the activities proposed to be funded by the fee to support the proposed backfill mechanism on policy grounds.

The Governor's proposal attempts to solve the CMU's funding challenges by allowing the CMU to recoup a greater share of its enforcement costs. The Governor's proposed legislation would allow the CMU to charge the awarding bodies for the difference between what the existing capped CMU fee pays for state bond-funded projects and actual CMU enforcement costs through "other funding sources tied to the project," and would also remove the CMU fee cap for projects that were not state bond-funded. However, since approximately 68 percent of the projects overseen by the CMU are projects that are entirely state bond-funded, the majority of CMU projects would not provide any additional funding for CMU enforcement costs under the Governor's proposal. It is likewise uncertain how feasible the proposal would be with respect to construction projects that included funding other than state bond funding, as it is uncertain whether project funding from sources other than state bond funds would be available in sufficient amounts to reimburse the CMU for its enforcement costs. Even if the CMU could fully recoup its costs in respect of projects with funding sources other than state bonds under the Governor's proposal, the Governor's proposal would still fund only a portion of the CMU's total enforcement costs given the large number of projects, the solely state bond-funded ones, that would be unaffected by the Governor's funding proposal. Additionally, in requiring local awarding bodies to pay CMU enforcement costs through "other available funding sources," the Governor's proposal raises concern over potential state mandate costs.

LAO Recommendations. Please see Figure 4 below for a summary of the LAO's recommendations.

Staff Comment. The Subcommittee has before it an inter-connected package of three separate budget proposals related to DIR regulatory assessments in support of existing workload. These proposals are necessary to ensure DIR's continued regulatory enforcement and compliance for two key program areas: occupational health and safety and labor standards enforcement. These proposals, as a package, also begin to streamline the myriad special fund funding mechanisms that support DIR's existing workload.

With regard to the CMU, staff notes that 2013-14 is a transition year, during which the CMU will operate at a funding level of $8.1 million with a dedicated source of funding that is not 100 percent reliant on billing. This is a keystone for making the CMU not only financially viable, but programmatically sound. The Administration indicates that it plans to undertake further reviews of the CMU during 2013-14, likely resulting in additional budget proposals in 2014-15.

Staff Recommendation: Adopt the staff recommendation as displayed in Figure 4 below and on the following page.

Figure 4: Recommendations on the Regulatory Assessment Related Budget Proposals

Administration Proposal	LAO Recommendation	Staff Recommendation
TBL to eliminate the sunset date and increase the annual revenue caps for the OSHF and LECF assessments.	Approve.	Adopt placeholder TBL per Administration proposal, including a technical correction to add a reference to the California Code of Regulation that was inadvertently omitted.
TBL to suspend collection of the high hazard assessment in years that the OSHF assessment is collected.	If the Legislature reauthorizes the OSHF assessment, repeal the high hazard assessment. If the Legislature does not reauthorize the OSHF assessment, allow the high hazard assessment to continue.	Adopt placeholder TBL to repeal the high hazard assessment contingent on the adoption of TBL to reauthorize the OSHF and LECF assessments.
Retain the staffing support for the high hazard assessment within the DIR budget.	Contingent on reauthorization of the OSHF assessment and repeal of the high hazard assessment, reduce OSHF expenditure authority by an additional $350,000 and four authorized positions.	Contingent on reauthorization of the OSHF assessment and repeal of the high hazard assessment, redirect the $350,000 and four positions previously associated with the collection of the high hazard assessment to the PSM unit within the Cal/OSHA program.
TBL to eliminate TICF funding for Cal/OSHA and backfill this funding with an offsetting OSHF assessment increase.	Given the availability of TICF fund balances, decrease OSHF expenditure authority in 2013-14 by $9 million and increase TICF expenditure authority by a like amount. Direct DIR to reduce the OSHF assessment for 2013-14 by $9 million.	Adopt placeholder TBL to sunset the TICF and designate the OSH fund as the successor fund. On a one-time basis in 2013-14, decrease the OSHF assessment level by the remaining balance in the TICF.

Figure 4 continued: Recommendations on the Regulatory Assessment Related Budget Proposals

TBL to shift civil penalties that were previously deposited into the Construction Industry Enforcement Fund to the LECF.	Approve.	Approve Administration proposal.
One-time loan of $5 million from the TICF to support CMU operations.	Approve.	Approve Administration proposal.
Permanently redirect $431,000 GF from the Injury and Illness Prevention program to support CMU operations.	Approve.	Approve Administration proposal.
Permanently redirect $2 million GF from the Prevailing Wage Determinations program to support CMU operations.	Reject.	Approve Administration proposal.
Adopt TBL to authorize DIR to recoup CMU enforcement costs that exceeded the existing 0.25 percent cap on bond proceeds on CMU fees by requiring awarding bodies to reimburse the CMU using "other funding sources tied to the project." The TBL would also remove the 0.25 percent cap on total project costs for projects that were not state bond-funded.	Reject and consider the following alternatives for the CMU: 1. Reduce expenditure authority and authorized positions in the CMU to a level supported by the $431,000 GF redirection. 2. Direct the Administration to develop an alternative and sustainable fee-based funding source for the CMU. 3. Increase General Fund support for the CMU. 4. Raise the caps on the existing CMU fee to increase funding for CMU operations.	Approve Administration proposal.

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