Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 5 Agenda

Senator Loni Hancock, Chair
Senator Joel Anderson
Senator Lois Wolk

Thursday, March 8, 2011
10:30 a.m. or upon adjournment of session
Room 113

Consultant: Kris Kuzmich

DEPARTMENTS TO BE HEARD

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

0559	Secretary for Labor and Workforce Development
1900	Public Employees' Retirement System
1920	State Teachers' Retirement System
7100	Employment Development Department
7350	Department of Industrial Relations
8380	Department of Human Resources
8885	Commission on State Mandates – Filipino Employee Surveys
CS 4.21	Health Care Premium Savings

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AGENDA – PROPOSED VOTE ONLY ITEMS

AGENDA – DISCUSSION / VOTE ITEMS

Items Proposed for Vote Only – Issue Descriptions

PUBLIC EMPLOYEES' RETIREMENT SYSTEM (1900)

Issue 1 – Mandated Reports: Expenditures for External Investment Advisors and Board of Administration Budgetary Expenditures

Background. Provisional language in the annual Budget Act requires the California Public Employees' Retirement System (CalPERS) to: (1) annually report on the estimated and final expenditures for external investment advisors and (2) to report on an estimated, quarterly, and final basis the Board of Administration's budgetary expenditures.

With regard to the budgetary expenditures report, CalPERS is requesting to modify the requirement and maintain only the final Expenditure Report. With regard to the external investment advisors report, CalPERS indicates that these reports are duplicative of information that is provided in its Comprehensive Annual Financial Report.

Staff Comment. Staff agrees that the Budget Act reporting requirements are either redundant or duplicative of information presented through other formal and annual reporting structures. Deleting these reporting requirements would also be consistent with the Governor's Executive Order B-14-11, which directed all state departments to identify legislatively-mandated reports that may no longer be of significant value to the Legislature, as part of the Administration's overall effort to identify and eliminate administrative inefficiencies and reduce costs.

Staff Recommendation: Approve the elimination of the budget provisional language requiring CalPERS to: (1) annually report on the estimated and final expenditures for external investment advisors and (2) to report on an estimated and quarterly basis the Board of Administration's budgetary expenditures.

Items Proposed for Vote Only – Issue Descriptions

STATE TEACHERS' RETIREMENT SYSTEM (1920)

Issue 2 – Mandated Report: Expenditures for External Investment Advisors

Background. Provisional language in the annual Budget Act requires the California State Teachers' Retirement System (CalSTRS) to annually report on the estimated and final expenditures for external investment advisors. CalSTRS indicates that this report is duplicative of information that is provided in other investment reports; further, actual expenditures for external managers are included in the Financial Section of the CalSTRS' Comprehensive Annual Financial Report.

Staff Comment. Staff agrees that the Budget Act reporting requirement is duplicative of information presented through other formal and annual reporting structures. Deleting this reporting requirement would also be consistent with the Governor's Executive Order B-14-11, which directed all state departments to identify legislatively-mandated reports that may no longer be of significant value to the Legislature, as part of the Administration's overall effort to identify and eliminate administrative inefficiencies and reduce costs.

Staff Recommendation: Approve the elimination of the budget provisional language requiring CalSTRS to annually report on estimated and final expenditures for external investment advisors.

Items Proposed for Vote Only – Issue Descriptions Continued

EMPLOYMENT DEVELOPMENT DEPARTMENT (7100)

Issue 3 – Expand the Financial Institution Records Match Program to the Employment Development Department

Governor's Budget Request. The January budget requests to expand the Financial Institution Records Match (FIRM), an enforcement tool used to collect delinquent taxes and non-tax debts of individuals and business entities, to the Employment Development Department, effective January 2013. Under this proposal, EDD would provide reimbursements to the Franchise Tax Board (FTB) of approximately $296,000 in 2012-13, $236,000 in 2013-14, and $150,000 on-going. The costs in the first two years are slightly higher due to one-time costs related to initial set-up, including licenses, hardware, and software, and to implement the FIRM process into the EDD's Automated Collection Enhancement System (discussed as Proposed Vote Only Issue 3 immediately below). This request includes proposed trailer bill language.

Prior Budget Action. Chapter 14, Statutes of 2011 (SB 86), authorized the Franchise Tax Board to operate and administer a FIRM that utilizes automated data exchanges to identify accounts of delinquent tax debtors held at financial institutions doing business in California. The FTB estimated that the use of FIRM would generate $43 million in additional GF revenues in 2011-12.

Background. A FIRM tool requires financial institutions doing business in California to match FTB records information on delinquent tax and non-tax debtors against their customer records on a quarterly basis. In addition to expanding the FIRM to EDD in 2012-13, the Administration also proposes to include the Board of Equalization (this aspect of the proposal will be discussed in Subcommittee No. 4). EDD estimates that 250,000 debtor records would be submitted on a quarterly basis using the FIRM tool; included in this batch of debtor records are other debts and/or penalty assessments referred to the EDD for collection, such as Department of Industrial Relations' debts. EDD estimates increased revenues of $6 to $12 million will be collected annually; roughly $3.1 to $6.2 million of this amount is new GF revenues.

Staff Recommendation: Approve the request and related trailer bill language.

Issue 4 – Automated Collection Enhancement System

Governor's Budget Request. The January budget requests a one-time augmentation of $8.8 million (various special funds) and 41 positions for year seven of the Automated Collection Enhancement System (ACES) project, an information technology project intended to improve EDD's ability to track, collect, and audit the payment of employer payroll taxes, including unemployment insurance and personal income taxes. Additionally, beginning in 2013-14 and on-going, $5.7 million (various special funds) and 22 positions are requested for on-going support of ACES. This request also includes proposed trailer bill language.

Prior Budget Actions. The ACES project began with the approval of the 2006 Budget Act. Since that time, the Legislature has annually provided funding for the development and implementation of the ACES project. Most recently, and in the 2011 Budget Act, $21.9 million ($19.5 million GF and various special funds) and 49.3 positions were provided to fund year six of the ACES project. The 2011 Budget Act also reduced EDD by 18 baseline positions that supported the Tax Accounting System (TAS) that are longer needed post implementation of ACES.

Background. EDD's Tax Branch is a major revenue collection organization for the state, receiving and processing approximately $50 billion annually from over 1.2 million registered California employers. The ACES project is modeled after the systems currently used by the Franchise Tax Board and Board of Equalization; it will increase the effectiveness of EDD's tax collection operations. ACES will also collect penalties and back-wages that are due to the Department of Industrial Relations (DIR), which were previously collected by the Franchise Tax Board. ACES "went live" and began final implementation on January 18, 2011.

The ACES project is a benefits-based procurement, whereby the additional revenue generated by the project offsets all project costs thereby minimizing risk for the state. The ACES solution is expected to increase GF revenue by $28.8 million (all funds total of $105.5 million) in 2012-13 by improving collection capabilities for delinquent accounts. The proposed trailer bill language is clean-up in nature, as it removes from statute the Franchise Tax Board's authority to collect delinquent accounts for the DIR. This statutory authority is no longer needed; as of January 31, 2012, ACES is collecting all delinquent accounts for DIR.

With regard to the on-going resources requested to support ACES, the Administration indicates that continued development, implementation, and support of interfaces will be pursued. These activities have been identified and prioritized by their ability to generate revenue, simplify existing work processes, and create efficiency through automation. In addition, there may be future requests to further expand ACES, such as to initiate electronic filing of liens with the Secretary of State and interagency offsets, such as interfaces between EDD, DIR, and the Board of Equalization.

Staff Recommendation: Approve the budget request and related trailer bill language.

Items Proposed for Vote Only – Issue Descriptions Continued

DEPARTMENT OF INDUSTRIAL RELATIONS (7350)

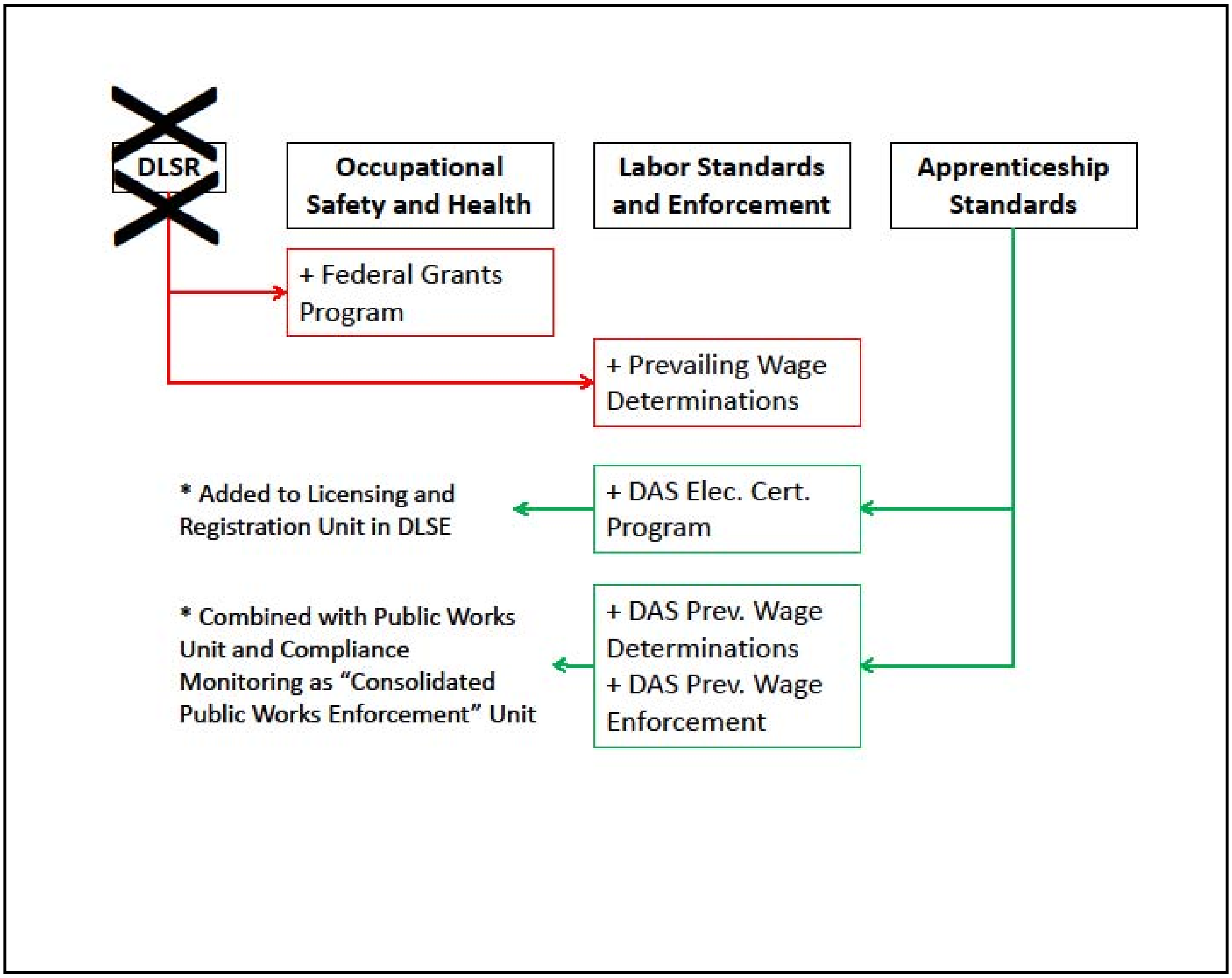
Issue 5 – Consolidated Public Works Enforcement

Governor's Budget Request. The January budget requests to eliminate the Division of Labor Statistics and Research (DLSR), transferring all responsibilities and workload to the Division of Occupational Health and Safety (DOSH) and the Division of Labor Standards Enforcement (DLSE) and otherwise reorganize the DIR as detailed further below. This consolidation will result in the reduction of one position and on-going savings of $231,000 GF. This request also includes proposed trailer bill language.

Background. The DIR is comprised of five programmatic divisions: (1) Labor Standards Enforcement-DLSE; (2) Occupational Safety and Health-DOSH; (3) Workers' Compensation Administration-DWCA; (4) Labor Statistics and Research-DLSR; and (5) Division of Apprenticeship Standards-DAS. DIR also has two units, State Mediation and Conciliation and Self Insurance Plans, and an Administration Division.

This request eliminates the DLSR and reassigns its principal responsibilities to the DLSE (determination of prevailing wage rates) and DOSH (job safety records, reports, and statistics). In addition, this proposal also creates an integrated Public Works unit within DLSE and consolidates within that unit: (1) existing public works investigation and enforcement at DLSE; (2) the Compliance Monitoring Unit, pursuant to Chapter 7, Statutes of 2009-10 Second Extraordinary Session, discussed as Proposed Discussion/Vote Issue 1 in the Department of Industrial Relations section of this agenda; (3) public works apprenticeship enforcement responsibilities currently performed by DAS; and (4) prevailing wage rate determinations currently performed by DLSR. Finally, this request transfers the administration and authority of the Electricians Certification Program and Fund from DAS to DLSE. Figure 1 on the next page illustrates this reorganization of DIR.

Figure 1 – DIR Reorganization to Eliminate the Division of Labor Statistics and Research and Establish Consolidated Public Works Enforcement with the Division of Labor Standards Enforcement



Staff Comment. This request will improve efficiency and effectiveness within DIR while reducing costs by: (1) eliminating DLSR as a separate division with two largely unrelated functions; (2) consolidating all public works enforcement responsibilities in an integrated unit; and (3) shifting the administration of the Electrician Certification Program to the enforcement division of DIR.

Staff Recommendation: Approve the request and corresponding trailer bill language to eliminate the Division of Labor Statistics and Research and establish consolidated public works enforcement within the Division of Labor Standards Enforcement.

Items Proposed for Vote Only – Issue Descriptions Continued

COMMISSION ON STATE MANDATES (8885)

Issue 6 – Filipino Employee Surveys

Governor's Request. The January budget requests the repeal of 32 of 56 currently suspended mandates that have been suspended for the past two years or more, including the local government mandate related to Filipino Employee Surveys. This request includes proposed trailer bill language.

Background. Budget funding for non-education mandate payments to local governments is included in the budget of the Commission on State Mandates (Commission). The Commission is responsible for determining whether a new statute, executive order, or regulation contains a reimbursable state mandate on local governments and determining the appropriate reimbursement to local governments from a mandate claim. The Constitution, as amended by Proposition 1A of 2004, requires that the Legislature either fund or suspend local mandates. In most cases, if the Legislature fails to fund a mandate, or if the Governor vetoes funding, the legal requirements are considered suspended pursuant to the Constitution. Suspending a mandate does not relieve the state of the obligation of reimbursing valid claims from prior-years, but it does allow the state to defer payment. The State owes local governments an estimated $1.6 billion in non-education mandate payments.

The Filipino Employee Surveys mandate has been suspended since 1990. It requires local agencies to categorize Filipino employees as a separate ethnic calculation in employee ethnicity survey and tabulations. The Administration asserts that this mandate should be repealed because other laws require similar information. Further, in the Administration's tabulation of the constitutionally-required 2012-13 GF expenditure if the mandates are neither suspended nor repealed, no funding is scheduled for the Filipino Employee Surveys.

Staff Comment. The Governor's mandate proposal is a continuation of the status quo in terms of mandates in effect and mandates not in effect. The substantive difference in this year's proposal is the Governor's request to amend statute to repeal 32 of the 56 mandates currently suspended. The difference between suspension and repeal does not affect budget savings because in either case the activity becomes optional for local governments and the state does not have to reimburse costs. The argument for repeal is that if the mandate will continue to be suspended in the foreseeable future, the statutory provisions should reflect that the activity is no longer required. Given that the Filipino Employee Survey mandate has been suspended since 1990, and other laws require similar information, staff recommends this mandate be repealed.

Staff Recommendation: Approve the request to repeal the Filipino Employee Survey mandate, including trailer bill language.

Vote on Vote-Only Issues 1 - 6:

1900 PUBLIC EMPLOYEES' RETIREMENT SYSTEM
CS 4.21 HEALTH CARE PREMIUM SAVINGS

Background. 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 ($1.4 billion other funds) in 2012-13.

Issue Proposed for Discussion / Vote

Issue 1 – Health Care Premium Savings

Governor's Budget Request. Via Budget Control Section 4.21 (CS 4.21), the January budget requires CalPERS to achieve savings of $45.4 million GF and $22.5 million other funds in the 2012-13 Health Benefits Program, and an equivalent amount of on-going savings. CalPERS is required to report before October 10, 2012, the savings achieved as well as their source.

Prior Budget Action. The 2011 Budget Act established CS 4.21 and required CalPERS to achieve one-time savings of $80 million GF and $35.7 million other funds in the 2011-12 Health Benefits Program, and an equivalent amount of on-going savings beginning in 2012-13. The 2011 Budget Act also included trailer bill language requiring CalPERS to negotiate with health plans to offer a core health care plan option to the existing portfolio of health plans and/or implement other measures to achieve the on-going savings. Finally, CalPERS was also required to notify the Joint Legislative Budget Committee and DOF before October 10, 2011, that the savings had been achieved as well as their source.

Background. CalPERS reported that it achieved savings of $46.7 million GF and $23.2 million other funds. These savings result from a number of one-time and on-going strategies adopted by the CalPERS Board, such as Value Based Purchasing and High Performance Provider Networks, to reduce premium costs.

CalPERS also reported that it achieved additional savings through the adoption of cost avoidance measures not accounted for in the above totals. More specifically, these additional savings totaled $15.9 million GF and $4.0 million other funds, and were a result of such activities as Pharmacy Benefit Changes, Integrated Healthcare Model, and Service Area Expansion.

With regard to 2012-13, the estimated funding of $2.9 billion GF ($1.4 billion other funds) represents a year-to-year increase of $246 million GF ($87 million other funds) over the 2011-12 expenditure level. This reflects an estimated 8.5 percent increase in health premium rates, which is the Department of Finance's projection based on the retiree health valuation report. Therefore, the savings targets identified in CS 4.21 for 2012-13 are the amount of savings not achieved in 2011-12, adjusted by the expected growth in premium costs.

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 report CalPERS submitted per the requirements of CS 4.21 in the current fiscal year, CalPERS has made progress not only in 2011-12 but also in prior years in pursuing numerous strategies to achieve savings in the Health Benefits Program. However, even with these extensive efforts, the 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.

From a more basic accounting and operational perspective, the budget structure that has been adopted, i.e., to use a control section mechanism, may not be ideal. The Health Benefits Program operates on a calendar year, with the premium rates adopted each June for the following calendar year, while the State Budget is based on a fiscal year approach. Further, the budgetary accounting does not afford the opportunity to "score" cost avoidance savings, yet these savings are legitimate. It is also worth noting that savings that are one-time in nature, while legitimate and with the potential for the identification of new ones each year, do not reduce baseline expenditure levels or result in on-going savings.

Finally, staff notes that the Administration has indicated that it is continuing to work with CalPERS and expects to submit additional proposals related to the health benefits program as part of the Spring budget process.

LAO Recommendation. Any savings resulting from this control section likely would have to be achieved through CalPERS premium negotiations. In April, CalPERS will begin the formal negotiation process for calendar year 2013 premiums. The CalPERS board is expected to approve the premium rates in June 2012. We think it is premature to assume any savings resulting from the 2013 premiums. Therefore, we recommend that the Legislature hold this item open until after the May Revision.

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

1. The report that CalPERS submitted, identifying the source of the 2011-12 savings, listed a number of broad descriptive titles. Please provide more detailed examples of activities within these titles, such as High Performance Provider Networks, which resulted in savings of $10.6 million, and Value Based Purchasing, which resulted in savings of $19.2 million.
2. For the cost avoidance savings CalPERS has reported, please provide more specific examples of savings achieved by adopting Pharmacy Benefit Changes, Integrated Healthcare Model, and Service Area Expansion.
3. With regard to one-time versus on-going savings, does CalPERS focus on one more so than the other? Should the primary focus be on on-going savings, as these savings reduce baseline expenditures?
4. As noted above, the 2011 Budget Act included trailer bill language requiring CalPERS to negotiate with health plans to offer a core health care plan option to the existing portfolio of health plans and/or implement other measures to achieve on-going

savings. Is CalPERS negotiating a lower cost health care plan? If not, what other cost savings measures is CalPERS negotiating?

Staff Recommendation: Hold open pending receipt of additional proposals as part of the Spring budget process.

Vote:

8380 DEPARTMENT OF HUMAN RESOURCES

Department and Budget Overview. Effective July 1, 2012, the Department of Personnel Administration's (DPA) organization code (8380) will be utilized for the new Department of Human Resources (CalHR). As of that date, and consistent with the Governor's Reorganization Plan Number 1 of 2011, DPA and the operational non-constitutional functions of the State Personnel Board (SPB) will be consolidated into the new CalHR.

CalHR will be responsible for managing the State's personnel functions and represents the Governor as the "employer" in all matters concerning state employer-employee relations. CalHR will be responsible for issues related to recruitment, selection, salaries, benefits, position classification, and provides a variety of training and consultation services to state departments and local agencies, including providing legal representation to state agencies for appeals of disciplinary actions and labor relations matters.

	2010-11* (actual)	2011-12* (estimated)	2012-12 (proposed)
Expenditures	$71,685	$79,635	$94,132
General Fund	$7,398	$6,410	$8,177
Personnel Years	206.7	245.0	242.0

*The years prior to July 1, 2012, represent the former Department of Personnel Administration structure and budgetary resources.

Issue Proposed for Discussion / Vote

Issue 1 – Governor's Reorganization Plan Number 1 of 2011

Governor's Budget Request. As a result of the Governor's Reorganization Plan Number 1 of 2011 (GRP 1-2011), the January budget requests transfer of budget authority from the Department of Personnel Administration (DPA) and State Personnel Board (SPB) to the new Department of Human Resources (CalHR), effective July 1, 2012.

Background. The GRP 1-2011 consolidated the human resource management functions and authorities previously vested with SPB and DPA, except for the constitutional responsibilities of SPB, into CalHR. The Administration asserts that, by consolidating the day-to-day operations of DPA and SPB into one consolidated agency, the state personnel system would be streamlined into functionally integrated programs that will end disjointed processes which are neither efficient nor cost effective. The GRP 1-2011 was effective on September 9, 2011.

Consistent with the GRP 1-2011, The SPB will continue 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 will provide administrative and staff support to enable the SBP to accomplish its mission.

Over the next two fiscal years, the Administration reports that CalHR will achieve its targeted budgetary savings, reducing staff levels by 15 percent (a total of 60 positions eliminated) and achieving savings of $8.6 million ($3.7 million GF). The savings are a result of the following:

- Elimination of the HR Modernization Project (effective July 1, 2011).
- Elimination of duplicate administrative functions such as budgets, human resources, and facilities operations.
- Elimination, reduction, or reclassification of redundant levels of management and supervisory staff and "flatten" the organization to increase each manager's level of supervision.
- Elimination or combination of communication, legislation, and clerical support functions.
- Streamlining, re-prioritization, and elimination of redundant processes as a result of the consolidation (for example, consolidation of the Career Executive Assignment review process at one agency and/or automation of processes such as seniority calculations).

At the time the GRP 1-2011 was before the Legislature, the Administration stated that staff reductions were expected to be achieved through attrition over the next few years. In addition, it was expected that efficiencies would be achieved in the line agencies with regard to more effective human resources functions, resulting in additional unquantified savings.

Staff Comment. Staff raises no concern with the budget request, as it is consistent with the GRP 1-2011 which was effectively adopted by the Legislature in 2011. Staff notes, however, a concern with a separate budget proposal that impacts the new CalHR. More specifically, as part of a larger government reorganization plan, the Governor is proposing to move CalHR under the new Government Operations Agency. Under the new organizational structure, the Director of CalHR would report to the Agency Secretary who would then report to the Governor. While this structure would not be an issue for many of CalHR's responsibilities, it could negatively impact labor relations, including collective bargaining; as it stands now, the Director of DPA directly reports to the Governor. Further, the timing of this reorganization plan is unknown, including whether it would be pursued through a formal GRP process or some other venue.

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

1. What is the timing of the reorganization plan to create a new Government Operations Agency that would include CalHR? Will this plan be pursued as part of a formal GRP or some other process?
2. How would CalHR's reporting relationship be structured under the new Agency, particularly with regard to labor relations and collective bargaining?

Staff Recommendation: Approve the budget request.

Vote:

0559 LABOR AND WORKFORCE DEVELOPMENT AGENCY

Department and Budget Overview. The Labor and Workforce Development Agency (LWDA) brings together the departments, boards, and commissions which train, protect, and provide benefits to employees. The LWDA is primarily responsible for three different types of functions: labor law enforcement, workforce development, and benefit payment and adjudication. The LWDA includes the Department of Industrial Relations (DIR), the Employment Development Department (EDD), the Agricultural Labor Relations Board (heard in Subcommittee No. 2), and the California Workforce Investment Board. The LWDA is funded through reimbursements from those departments. The LWDA provides policy and enforcement coordination of California's labor and employment programs and policy and budget direction for the departments and boards.

	2010-11 (actual)	2011-12 (estimated)	2012-13 (proposed)
Expenditures	$3,035,000	$2,297,000	$2,295,000
General Fund	0	0	0
Personnel Years	13.9	11.4	11.4

Issue Proposed for Discussion / Vote

Issue 1 – Economic and Employment Enforcement Coalition

Governor's Budget Request. The January budget removed budget provisional language requiring the LWDA to report on the progress of the Economic and Employment Enforcement Coalition (EEEC), a federal-state multi-agency partnership formed to combat the worst violators of federal and state labor, licensing, and tax laws operating in the underground economy. In addition to LWDA, the other state departments that comprise the EEEC include the DIR, EDD, and the Contractors State License Board (CSLB).

Prior Budget Actions. The initial EEEC budget request was approved as three-year limited term in the 2005 Budget Act; the 2008 Budget Act extended the EEEC for two additional years. The 2010 Budget Act permanently established the EEEC, with 66 positions and on-going funding of $7.208 million (special fund and reimbursements). Those positions were allocated as follows: LWDA – one position; DIR – 29 positions; EDD – 25 positions; and CSLB – 11 positions. The 2011 Budget Act required LWDA to report by January 1, 2012, on the progress of the EEEC and transferred authority for the EEEC from the LWDA to the DIR, as part of a larger reorganization of LWDA.

Background. The goal of the EEEC is to target violators who operate in the underground economy and assist legitimate businesses that do comply with California law. Within the underground economy, employers utilize various illegal schemes to conceal their true tax liability, as well as reduce their operating costs associated with insurance, payroll taxes, licenses, employee benefits, safety equipment, and safety conditions.

The LWDA submitted the required January 1, 2012, EEEC progress report on February 28, 2012. The report states that the EEEC focused its efforts on traditionally low-wage industries, including agriculture, car wash, garment manufacturing, janitorial service, horse racing tracks, and restaurants. Further, since its inception in July 2005, EEEC enforcement activities involved 7,296 business inspections, during which compliance checks identified 49,433 violations of labor, licensing, and tax laws, valued at $62.8 million in penalty assessments. EEEC activities also resulted in 3,446 cases being referred to District Attorney's Offices, with 1,696 criminal convictions. These violations represent employers who were using unlawful tactics to achieve an unfair competitive advantage over law abiding employers.

In January 2012, as reported in the *SF Chronicle*, the EEEC was reconstituted and renamed the Labor Enforcement Taskforce. The Administration did not notify the Legislature or staff of these changes. The Administration indicates that the changes were made in this time of scarce resources so the effort would be directed closely by the two key programs that enforce labor law issues. The Administration reports that all partner agencies of the EEEC are part of the reconstituted Taskforce, and that the Board of Equalization and Department of Insurance are new secondary partners. The Administration also reports that the Taskforce will be focusing more on labor law violations, specifically in low wage industries, with targeting of employers empirically based. Finally, the Taskforce intends to evaluate the effectiveness of its efforts.

Staff Comment. The EEEC was a budget creation; there is no statutory citation that delineates program priorities or parameters. The Administration asserts that the functions of the reconstituted and renamed Labor Enforcement Taskforce are consistent with the initial 2005-06 budget request that established the EEEC – the changes were made to more effectively communicate to employers and employee's the program's overall purpose; i.e., the name change is simply semantics. However, the prior name was reflective of the EEEC's mission to combat the worst operators in the underground economy who violate federal and state laws beyond just labor laws – the mission specifically includes licensing and tax laws. As noted above, the January 2012 progress report was submitted late. This report also speaks to prior activities of the EEEC; not the reconstituted Labor Enforcement Taskforce. Further, with the deletion of any requirement to report to the Legislature in future years, there is no formal venue to ensure the Taskforce's consistency with the original mission to combat the worst violators of federal and state labor, licensing, and tax laws operating in the underground economy.

Given these issues, the Subcommittee may wish to consider whether trailer bill language is warranted to formalize this effort against the underground economy, as well as reinstituting a periodic reporting requirement either through trailer bill language or the budget bill.

Staff Recommendation: Hold open.

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.

	2010-11 (actual)	2011-12 (estimated)	2011-13 (proposed)
Expenditures	$26,975,292,000	$20,437,306,000	$14,331,715,000
General Fund	$38,943,000	$344,379,000	$438,758,000
Personnel Years	11,237.1	10,097.1	10,073.1

Issues Proposed for Discussion / Vote

Issue 1 – Unemployment Insurance Loan Interest Payment

Governor's Budget Request. Similar to the approach taken in the 2011 Budget Act, the January budget requests a loan of $417 million from the Unemployment Compensation Disability Fund (DI Fund) to the GF to pay the September 2012 interest payment due to the federal government for the quarterly loans the Employment Development Department (EDD) has been obtaining from the federal government since January 2009 to cover the Unemployment Insurance (UI) Fund deficit and make payments to unemployment insurance (UI) claimants without interruption. This portion of the request includes budget bill provisional language.

To fund future interest payments for funds borrowed from the federal government to pay UI benefits, and to repay the funds borrowed from the DI Fund in both 2011 and 2012, the January budget requests to increase, through trailer bill language that requires a 2/3rds vote (effective January 1, 2013), the employer surcharge payable to the Employment Training Fund by a total of $472.6 million ($39 per employee). The surcharge would be eliminated once the UI debt to the federal government is fully paid back and there is no longer a need to pay interest payments. Until that point is reached, the Administration indicates that this proposal would increase taxes on nearly every California employer by between $40 and $61 per employee per year, fluctuating each year to fully fund the interest costs due to the federal government.

In conjunction with the employer surcharge, and through trailer bill language, the January budget proposes to increase the minimum monetary eligibility to qualify for UI benefits to account for increases in employee wages that have occurred since the requirements were last adjusted in 1992. Under current law, to meet monetary eligibility requirements, a claimant must have earned: (1) at least $900 in a single quarter and total base period earnings of $1,125 or (2) at least $1,300 in any one quarter in the base period. The budget increases the minimum eligibility to: (1) $1,920 in the highest quarter and total base period earnings of $2,400 or (2) at least $3,200 in any one quarter in the base period. With these changes, approximately 40,000 individuals would no longer be eligible for UI benefits, saving $30 million per year.

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, 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 numbers of 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 to qualifying claimants without interruption. The UI fund deficit was $9.8 billion at the end of 2011 and is expected to increase to $11.7 billion at the end of 2012. 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 the budget includes an interest payment due in September 2012 totaling $417 million (estimated). 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.

The September 2011 interest payment of $303.5 million was made by borrowing funds from the Unemployment Compensation Disability Fund (DI Fund). Under current law, those funds are to be repaid from the GF to the DI Fund by 2016.

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. Due to California carrying an outstanding loan balance for two consecutive years, the Federal Unemployment Tax (FUTA) credit will decrease from 5.4 percent to 5.1 percent on January 1, 2012. This will result in employers paying an additional $21 per employee per year; the aggregate increase in employer costs in 2012 is $300 million (estimated). These additional federal taxes pay down the principal on the federal loan. The FUTA credits will continue to decrease by 0.3 percent each year until the federal loans are paid in full (and the UI fund is solvent). In 2013, the increased cost is $50 per employee (estimated); the aggregate increase in employer costs in 2013 is $606 million (estimated).

The DI program is a component of State Disability Insurance (SDI) and provides benefits to workers who are unable to work due to pregnancy or a non-work related illness or injury. The SDI program taxes covered employees up to a statutory ceiling, which is projected to increase to $93,316 in 2011. The statutory formula for calculating the SDI contribution rate helps to maintain an adequate DI Fund balance. While contributions account for the majority of total receipts to the DI Fund, interest earnings and other receipts are also included in the DI Fund balance.

The $417 million loan interest payment figure is an estimate based on two primary factors: (1) the interest rate the federal government charges the state and (2) the amount of federal funds the state has borrowed. The January budget estimated a federal interest rate of 4.09 percent. On February 13, 2012, the federal government released the 2012 interest rate; it was lowered to 2.943 percent, resulting in the estimated September 2012 payment dropping to $330 million. The Administration indicates that it will provide an updated interest payment calculation during the May Revision.

Staff Comment. In developing its proposal, the Administration indicates that it took into consideration the current state of the economy and its recovery, and the potential cost impacts that an overall UI solvency proposal would present to employers (and the economy). By acting now to comprehensively address UI fund insolvency, the Legislature could stop the growth of the UI fund deficit and reduce associated state interest costs. On the other hand, such actions have the disadvantage of increasing employer costs and/or decreasing aid to unemployed workers during a difficult economic time for the state. However, continuing with a large outstanding federal loan will also increase costs to employers through reduced federal tax credits. The January budget does not include a proposal to address the underlying insolvency of the UI fund.

The Administration also points to the fact that there are 28 other states that face a similar situation with their UI Fund, indicative that this is a national issue which may be addressed on the federal level. In its July 2011 report entitled, *Managing California's Insolvency: The Impact of Federal Proposals on Unemployment Insurance*, the LAO noted that three federal proposals had been introduced to address the insolvency issue and determined that all three would improve the solvency of California's UI fund. More recently, as part of his 2013 budget proposal, President Obama proposed to: (1) provide employers in indebted states with tax relief for two years; (2) raise the minimum level of wages subject to unemployment taxes in 2015 to a level slightly less in real terms than it was in 1983 – for California this would increase the current wage base of $7,000 to approximately $15,000 – offset by lower tax rates to avoid a Federal tax increase; and (3) a number of other steps to address program integrity, such as preventing improper payments and reducing error rates.

At this juncture, it remains unclear whether any federal reforms will be enacted. This uncertainty complicates the Legislature's decision as to how it should address the insolvency of its UI fund. The LAO recommended that regardless of whether Congress acts to address the UI insolvency problems faced by California and other states, the Legislature should ensure implementation of a long-term solvency plan by 2014. If federal reforms are enacted, it is likely that no additional action by the Legislature will be necessary to ensure long-term solvency. However, if no federal reforms are enacted, it will be critically important for the Legislature to adopt its own long-term solvency plan.

Similar to language contained in the 2011 Budget Act, this request is accompanied by budget bill provisional language to: (1) authorize the Department of Finance to increase/decrease the actual amount paid/borrowed from the DI fund based on a more precise calculation of the interest due; and (2) specify that the annual contribution rates for the DI fund shall not increase as the result of any loan made to the GF (i.e., in calculating the annual disability insurance tax rate each year, the EDD shall treat outstanding DI loans as available cash in the DI Fund). This latter provision is pivotal to preventing any potential increase in employee-paid DI taxes as a result of the loan from the DI Fund to the GF.

LAO Recommendation. Consistent with our previous reports, we continue to recommend that, in the absence of federal UI reforms, the Legislature adopt a comprehensive plan to ensure the long-term solvency of the UI fund. We suggest that such a plan be balanced, including both actions on the revenue side (increased employer taxes) and the cost side (decreased UI benefits). The Governor's proposals fall short of being a comprehensive plan to address the long-term solvency of the UI fund. However, we find that the Governor's proposals merit consideration if included in a comprehensive long-term solvency plan. If a future long-term solvency plan included increased employer taxes, dedicating a portion of these increased revenues to making interest payments on the state's federal loan, in a manner similar to that proposed by the Governor, would avoid significant GF costs in future years. Also, we concur with the Governor's assessment that monetary eligibility thresholds should be updated to reflect changes in wage levels.

We recognize that, in light of uncertainty regarding federal UI reforms and the recovery of California's labor market, the Legislature may wish to take a wait-and-see approach during 2012 and delay enactment of a long-term solvency plan until next year. Enactment of a long-term plan will likely necessitate significant legislative deliberation and compromise among the various stakeholders of the UI system. For this reason, if the Legislature elects to delay addressing UI fund insolvency, we think that is would be premature to enact the Governor's proposed employer surcharge and monetary eligibility changes. Under this scenario, we would recommend that the Legislature postpone considering the Governor's proposals until they can be considered as part of a long-term solvency plan. In the interim, continuing the current-year strategy of borrowing from the DI fund to cover the state's federal interest payment, creating short-term GF savings, is warranted by the state's fiscal condition.

Staff Recommendation: Approve the loan of $417 million from the Unemployment Compensation Disability Fund to the GF to pay the September 2012 unemployment insurance loan interest payment due to the federal government, including the budget provisional language. Reject the other aspects of the request, including proposed trailer bill language, pertaining to (1) the Employment Training Fund surcharge and (2) income eligibility for unemployment insurance benefits.

Vote:

Issue 2 – California Unemployment Insurance Appeals Board: Restructuring Second Level Appeals

Governor's Budget Request. The January budget requests, effective January 1, 2013, the elimination of the California Unemployment Insurance Appeals Board (CUIAB) and proposes a restructured second level appeals process for half-year savings of $600,000 ($3,000 GF, $552,000 federal funds, and $45,000 other funds) in 2012-13 and full-year savings of $1.2 million in 2013-14 and on-going. The request also includes proposed trailer bill language.

Background. The CUIAB was established in 1943 to provide due process for California claimants and employers who dispute unemployment and disability insurance benefit and payroll tax determinations made by the EDD. The structure at the CUIAB provides due process appeals for claimants, employers, and the EDD, and is presided over by a seven-member board. Five of these members are appointed by the Governor, with Senate confirmation, and the other two members are legislative appointees. Current law requires that two of the seven members be attorneys and that the Governor select the Chair. Current law also requires that each member of the board devote his/her full time to the performance of his/her duties. Members are compensated $128,109 a year; the Chair is compensated $132,179 per year.

California is one of 49 states and territories that provide workers and employers with two levels of appeals. The federal government does not require second level appeals; however, the federal government does reimburse states for the costs of second level appeals. The second level appeal process also takes pressure off the superior court system.

The first, or lower appeal, is an appeal to an Administrative Law Judge (ALJ) in CUIAB Field Operations. The second, or higher level, is an appeal of the decision made by the Field Operations ALJ. These appeals are submitted to CUIAB Appellate Operations where they are reviewed by ALJs and decided by Board Members. More specifically, when a claimant, employer, or EDD disagrees with the decision of the first-level ALJ, he or she may appeal to the Board. Each appeal is reviewed by a second level ALJ who then prepares a proposed written decision which is sent to two Board members. The Board members review the case and the second-level ALJ's decision and decide the appeal case as a panel. If the two Board members cannot agree, then the Board Chair resolves the impasse.

In fiscal year 2011-12, CUIAB's budget totaled $102.5 million to administer the appeals program with approximately 92 percent from the federal government, 7.4 percent from state special funds, 0.5 percent from the GF, and 0.2 percent from other funds. The small amount of state GF is used to adjudicate appeals for state-only programs, such as personal income tax liability and collection cases, as federal law prohibits using federal funds for these purposes. Since the recession began in 2007, CUIAB has seen its workload increase to unprecedented levels for both first and second level appeals. The CUIAB remains designated "at risk" for 2012 by the federal Department of Labor (DOL) because the state has not achieved the acceptable level of performance for appeals promptness. In making this designation, DOL acknowledged that CUIAB has made performance improvements. For instance, as of December 2011, the CUIAB backlog of second level appeal cases totaled 3,792, with an average age of 39 days, statistics near the federal DOL standard. However, the CUIAB resolved only 17.2 percent of its cases within 45 days, well off the federal DOL standard of 50 percent of cases.

This request would eliminate the board, add a Bureau Director who would be a Governor's appointee subject to Senate confirmation, and would have four second level ALJ positions, which currently act as board authors, reclassified as "Presiding" ALJS (PAJLs) authorized to independently review and decide cases. To ensure impartiality, quality, and consistency, CUIAB would implement a quality control practice for decisions. The Board's other duties would be assigned to permanent civil service staff. These duties would include: establishing precedent decisions; promulgating regulation; approving the CUIAB budget; and overseeing the administration of the agency. Finally, the Board would be changed to a Bureau; in addition to the new Director, the following positions would be established: Chief of the Field Office; Chief of the Appellate Office; General Counsel over the Legal Office; Special Assistant to the Bureau Director; and Chief of the Project Team and Research Office.

Staff Comment. Staff acknowledges the obvious diligence and effort that was undertaken by the Administration in the past year developing this proposal to restructure CUIAB second level appeals; however, many unresolved questions remain. It is not clear how replacing a board where the majority of the members are subject to Senate confirmation, with a Bureau where only the director is subject to Senate confirmation, provides the same level of legislative oversight and checks and balances. This proposal also does nothing to improve the performance of the second level appeals process; rather, it would essentially maintain the status quo as to workflow and timeliness of second level appeals. Additionally, under the current process, all parties, i.e., employers, claimants, and the EDD, benefit from a third party arbitrator. It is not clear that the restructured process would provide the same level of benefit. The restructured Bureau would also not provide 100 percent review of the second level ALJ decisions, which potentially affects the quality and consistency of decisions over time. Under the current structure, 100 percent review is provided. The budgetary savings attached to this proposal are minimal, with insignificant savings to the GF. Further, the restructured Bureau could also increase caseload (and costs and delays) in the civil court system, a system which has seen extensive budget reductions in recent years. Given these and other issues, the Subcommittee may wish to hold this request open to allow further time for consideration and consultation with the policy committee, including the proposed trailer bill language.

Staff Recommendation: Hold open.

Vote:

Issue 3 – California Unemployment Insurance Appeals Board Administrative Consolidation

Governor's Budget Request. The January budget requests an on-going adjustment to reflect cost savings from shifting the administrative functions of the California Unemployment Insurance Appeals Board (CUIAB) to the EDD, thereby reducing staffing by 18 positions and costs by $2 million ($9,000 GF and various special funds). This adjustment is separate and apart from Issue 2 above, which would restructure the CUIAB's second level appeals process.

Background. The CUIAB was established in 1943 to provide due process for California claimants and employers who disagreed with benefit and tax determinations made by the EDD. Initially, the EDD provided administrative support to the CUIAB. During the 1990s, the CUIAB established its own administrative support functions, which involved replicating and staffing an administrative support system for facilities, procurement, budget, and personnel. The CUIAB administrative services branch is staffed with 49 positions and is comprised of four divisions: (1) Business Services; (2) Personnel Services; (3) Budget and Workload; and (4) Strategic Planning and Training.

During an economic recession, the demand for unemployment insurance (UI) services grows exponentially, including appeals activities. Based on the workload associated with UI services in the last several years, the federal Department of Labor increased the state's federal grant funding. In the reverse, as the economy continues to improve, UI workload will decrease as will the federal grant funding. The Administration indicates that this request begins the process to "right-size" the CUIAB and EDD, creating further efficiencies, all of which must occur within the next two fiscal years.

The administrative shifts would occur within the CUIAB Business Services, Human Resources, and Budget and Workload Divisions, to the EDD's Business Operations, Planning, and Support Division, Fiscal Programs Division, and Human Resources Division. The CUIAB Training Unit will remain with the CUIAB, but within the Field Operations unit.

Staff Comment. Current law mandates autonomy and independence for the CUIAB from EDD in establishing its budget and in personnel appointments for CUIAB, to ensure the operational independence of CUIAB and the impartial adjudication of unemployment insurance appeals. This administrative consolidation is consistent with current law, as the CUIAB will retain authority over these issues; EDD will simply handle the ministerial aspects of these functions for the CUIAB. Further, agreements are being completed between CUIAB and EDD to create appropriate levels of support from EDD to ensure that the authority the CUIAB has over budget and personnel is not interfered with.

Staff Recommendation: Approve the 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.

	2010-11 (actual)	2011-12 (estimated)	2012-13 (proposed)
Expenditures	$359,739,000	$412,395,000	$425,114,000
General Fund	$4,235,000	$4,556,000	$4,392,000
Personnel Years	2,449.9	2,701.8	2,717.3

Issues Proposed for Discussion / Vote

Issue 1 – Compliance Monitoring Unit Cash Flow

Governor's Budget Request. The January budget requests provisional language in the annual Budget Act to allow the State Public Works Enforcement Fund (SPWEF) to borrow from the Uninsured Employers Benefits Trust Fund (UEBTF), Labor Enforcement and Compliance Fund (LECF), and/or the Construction Industry Enforcement Fund (CIEF), for cash flow purposes.

Background. Chapter 7, Statutes of 2009-10 of the Second Extraordinary Session, established a dedicated program (Compliance Monitoring Unit) and funding source within DIR to enforce prevailing wage requirements on specific public works projects as a replacement for enforcement through Labor Compliance Programs. In addition, Chapter 7 established the SPWEF, and authorized the DIR Director to determine and assess a fee in an amount not to exceed one-quarter of one percent of the bond proceeds on bonds issued by the State to fund public works projects.

The nature of bond funding requires that the Compliance Monitoring Unit program expenses may only be charged in arrears, and may not exceed actual expenses incurred. Therefore, a cash flow loan will be needed on an annual on-going basis to allow the program to operate and fulfill its statutory mandate.

Chapter 378, Statutes of 2011, among others, authorized a loan not to exceed $4.3 million from the UEBTF to the SPWEF to meet the start-up needs of the Compliance Monitoring Unit.

Staff Comment. Given that the program can only bill in arrears, and may not exceed actual expenses, if this borrowing structure is not authorized, the Compliance Monitoring Unit will not be able to operate and meet its statutory mandate. Given this, this request is essentially an annual loan that will be paid back but then re-borrowed again and again. This request authorizes borrowing from three other funds, two of which receive revenue, at least in part, from an employer assessment that is variable. Therefore, there is a concern that permitting this borrowing from the Uninsured Employers Benefits Trust Fund-UEBTF and Labor Enforcement and Compliance Fund-LECF could result in a need to increase employer assessments; i.e., borrowing from the UEBTF or the LECF could reduce the amount available to fund the activities that would otherwise be funded by the fund necessitating an increased assessment. Therefore, the Subcommittee may wish to consider modifying the requested provisional language to specify intent that the annual assessments for the UEBTF and LECF shall not increase as the result of any loan made to the SPWEF.

Staff Recommendation: Approve the provisional budget language, as modified, to allow the State Public Works Enforcement Fund to borrow from the Uninsured Employers Benefits Trust Fund, Labor Enforcement and Compliance Fund, and/or the Construction Industry Enforcement Fund for cash flow purposes.

Vote:

Issue 2 – Implementation of 2011 Legislation Supported by the Labor Enforcement and Compliance Fund: Prevailing Wage Violations (AB 551) and Willful Misclassification of Independent Contractor (SB 459)

Governor's Budget Requests. The January budget requests increased expenditure authority from the Labor Enforcement and Compliance Fund (LECF) to comply with two recent statutory changes, as follows:

1. **Prevailing Wage Violations (Chapter 677, Statutes of 2011 – AB 551)**

   Summary. The January budget requests $765,000 and four positions in 2012-13, and $639,000 on-going, to comply with the requirements of Chapter 677, Statutes of 2011 (AB 551), related to prevailing wage violations. Of the requested resources in 2012-13, $100,000 is for one-time costs to redesign and/or upgrade the existing database system.

   Background. In its consideration of Chapter 551, the Legislature was presented with the following question: "Should the penalties for failing to pay prevailing wages on public works projects and failing to provide payroll records in a timely manner be increased, as well as create a process for debarment for failing to follow the laws governing public works contracts, to encourage compliance with public works laws and the payment of the prevailing wage?"

   In answering that question, Chapter 677 (1) increases the penalty assessed from $20 to $80 to contractors and subcontractors with previous violations and from $30 to $120 for willful violations; (2) requires the Labor Commissioner to maintain a Web site listing of contractors who are ineligible to bid on or be awarded a public works contract and at least annually notify awarding bodies of the availability of the list of disbarred contractors; and (3) states that the Labor Commissioner notify the contractor or subcontractor that, in addition to any other penalties, the contractor shall be subject to disbarment if certified payroll records are not produced within 30 days after receipt of written notice. Failure to comply by that deadline would prohibit the contractor from bidding on or be awarded a contract for public work or performing work as a subcontractor on a public works project for three years.

2. Willful Misclassification of Independent Contractor (Chapter 706, Statutes of 2011 – SB 459)

Summary. The January budget requests $1.7 million and 13 positions in 2012-13, and $1.65 million on-going, to comply with the requirements of Chapter 706, Statutes of 2011 (SB 459), related to willful misclassification of independent contractors.

Background. In its consideration of Chapter 706, the Legislature was presented with the following question: "Should California employers and the DIR be required to take specified actions to decrease the incidence of misclassification of workers as independent contractors and should the law governing classification of persons as independent contractors provide civil penalties for willful misclassification of an employee as an independent contractor?

In answering that question, Chapter 706 prohibits the willful misclassification of an individual as an independent contractor rather than as an employee and provides that persons or employers violating the prohibition are subject to specified civil penalties as assessed by the Labor and Workforce Development Agency or a court.

Staff Comment. Staff notes no concern with the programmatic specifics of these requests, as they are consistent with the legislation that was approved by the Legislature last year. With regard to the budget resources, staff notes that the levels of requested resources are beyond that which was estimated last year by the Appropriations Committees in their analyses of the bills. DIR indicated to staff that it regrets the discrepancies between the information initially provided to the Appropriations Committees and the resources contained in these requests. Apparently communication breakdowns internal to DIR caused this to occur. DIR has assured both budget and fiscal staff that such discrepancies will not occur in the future.

In addition, staff notes that the requested resources are permanent, yet the workload estimates are less certain as these are new activities and there are unknowns as to the actual amount of workload that will materialize. Therefore, in considering these requests, the Subcommittee may wish to consider authorizing the resources on a two-year limited-term basis to allow the resource levels to be revisited in two years' time when actual workload will be known.

Staff notes several concerns about the Labor Enforcement and Compliance Fund (LECF), which is the fund source supporting these requests. As part of the 2009 Budget Act, the GF costs of the Labor Standards Enforcement and the Occupational Safety and Health Programs ($15.2 million and $24.8 million, respectively) were shifted to fees – trailer bill language was adopted (Chapter 12, Statutes of 2009-10 Fourth Extraordinary Session) establishing the LECF and an assessment structure based on the size of the employer. The surcharge levied would not exceed $37,000,000. The statutory authorization for the LECF sunsets on June 30, 2013. At present the Subcommittee does not have a proposal before it to reauthorize the LECF, yet these requests would utilize the LECF on a permanent basis. Further, given the current statutory cap on the overall level of funding in the LECF, it appears that there are inadequate resources in the LECF to sustain both current activities and the new activities contained in these requests on an on-going basis.

The Administration indicates that it is currently considering a request from DIR to pursue LECF reauthorization. Staff expects receipt of this proposal as part of the spring budget process. Therefore, the Subcommittee may wish to defer action on these requests until such time as the Administration submits a comprehensive proposal to reauthorize the LECF. With that proposal in hand, the Subcommittee would be better positioned to consider these requests to implement legislation from 2011 supported by the LECF.

LAO Recommendation. In general, we find that the LECF is an appropriate funding source for implementation of Chapter 677 and Chapter 706, as proposed by the Governor. However, authorization for the LECF is scheduled to expire at the end of 2012-13. Given that there is currently no plan for reauthorization of the LECF, it is premature for the Legislature to consider establishing new permanent positions supported by this fund. Therefore, we recommend the Legislature consider the administration's forthcoming proposal on reauthorization of the LECF prior to considering the Governor's proposal to establish these positions.

We concur with the Administration's finding that implementation of Chapter 677 and Chapter 706 will result in increased workload for DLSE. Little empirical workload data currently exists to inform a precise calculation of this increased workload. Accordingly, the Administration has estimated the increased workload based on limited available data, institutional knowledge, and experience. In light of this, we recommend that should and when the Legislature approves the requested positions to implement Chapters 677 and 706, it approves them as two-year limited term to provide time for collection of better workload data.

Staff Recommendation: Hold open and defer action on these requests pending receipt of additional information from the Administration.

Vote:

Issue 3 – Employee/Employer Education and Outreach

Governor's Budget Request. The January budget requests three-year limited-term increased expenditure authority of $2.3 million in 2012-13, and $1.6 million in 2013-14 and 2014-15, from the Labor and Workforce Development Fund (LWDF) and four redirected positions, to increase the overall efficacy of statewide enforcement of labor laws.

Background. The mission of the DIR is to protect the California workforce, improve working conditions, and enhance opportunities for profitable employment. These responsibilities are carried out through three major programs: the adjudication of workers' compensation disputes; the prevention of industrial injuries and deaths; and the enforcement of laws relating to wages, hours, and working conditions. With regard to the latter, the Labor Code vests authority with DIR to enforce minimum labor standards to protect employees and to protect employers who comply with the law from those employers who attempt to gain an advantage by failing to comply with minimum labor standards. These activities comprise the day-to-day work of DIR and have also periodically been the focus of targeted campaigns funded in an additive fashion to DIR's budget, such as: (1) the 2009 Budget Act proposal to provide $1.5 million to conduct a targeted outreach campaign to reduce the incidence of heat-related illness in the workplace and (2) the 2005 Budget Act proposal to establish the Economic and Employment Enforcement Coalition (EEEC), a partnership of state and federal agencies charged with targeted enforcement against unscrupulous businesses participating in the "underground economy."

This request builds on these efforts on a limited-term basis utilizing funding available and accrued from Chapter 906, Statutes of 2003. Chapter 906 allows employees to sue their employers for civil penalties for employment law violations. Any penalties recovered under this chapter are required to be distributed 75 percent to the Labor and Workforce Development Agency (LWDA) for enforcement of labor laws and education of employers and employees about their rights and responsibilities, and 25 percent to the aggrieved employee. The funds directed to LWDA are deposited in the Labor and Workforce Development Fund. Currently, DIR does not receive an appropriation from this fund. Since its inception, the fund has been underutilized with revenue outpacing annual expenses.

The resources in this request would be split between two divisions at DIR: (1) Division of Labor Standards Enforcement and (2) Division of Occupational Safety and Health, as illustrated in Figure 2 below.

Figure 2 – Expenditure Plan for Employee/Employer Outreach

Division of Labor Standards Enforcement (DLSE)			
#	**DESCRIPTION**	**2012-13**	**2013-2015**
1	Translation & duplication of wage claim video and written resources for waiting rooms.	$432,000	
2	Development of language cards for investigators.	$3,000	
3	Educational outreach partnerships with industry groups and other public agencies.	$374,000	$374,000
4	Educational outreach via ethnic media outlets.	$135,000	$100,000
5	Educational outreach via out-of-home (outdoor) advertising.	$135,000	$100,000
6	Employer training regarding labor costing and litigation pursuant to LC Section 2810.	$371,000	$221,000
	DLSE Grand Total	**$1,450,000**	**$795,000**
Division of Occupational Safety and Health (DOSH)			
#	**DESCRIPTION**	**2012-13**	**2013-2015**
1	Media buys for heat outreach to agricultural workers and employers.	$200,000	$200,000
2	Integrated training programs on significant hazards for internal staff, joint external training.	$450,000	$450,000
3	Multilingual outreach materials.	$100,000	$100,000
4	Training of trainers for worker organizations to better utilize and communicate with DOSH.	$100,000	$100,000
	DOSH Grand Total	**$850,000**	**$850,000**
	Department of Industrial Relations Grand Total	**$2,300,000**	**$1,645,000**

Staff Comment. The Administration has affirmed that the resources in this request will not overlap or otherwise duplicate the efforts of the EEEC; for instance, there will be close coordination to ensure strategic coverage across the state and reach the broadest audience. The media components of this new outreach also build on prior lessons learned, primarily from the 2009 Budget Act appropriation pertaining to heat-related illnesses. The lesson learned from that campaign was that billboard and radio ads were the most effective communication tool; therefore, DIR indicates that this new outreach effort will not utilize television media.

With regard to outcomes, since this is a limited-term outreach effort, the Administration indicates that it will undertake a statistical analysis of the number of: citations issued; self-audits to reimburse employees for minimum wages and overtime; number of complaints alleging labor law violations; violations found during inspections; wages recovered for workers; number of attendees at outreach events and whether compliance increases following such outreach; and, litigation brought to protect workers and hold violators responsible. Given that this outcome analysis is already planned, in considering approval of this request, the Subcommittee may wish to require a written report of the outcomes and achievements of the outreach effort when it concludes in fiscal year 2014-15.

With regard to the proposed fund source, as noted in Issue 2 above pertaining to the implementation of 2011 legislation supported by the Labor Enforcement and Compliance Fund, the Subcommittee may wish to delay action on this request until such time that an on-going fund source has been identified to implement those identified legislative priorities.

LAO Recommendation. The Governor's proposed education and outreach activities are consistent with DIR's mission to protect California's workforce, improve working conditions, and enhance opportunities for profitable employment. Additionally, these activities are an appropriate use of LWDF funding. However, uncertainty regarding the availability of future funding from the LECF may necessitating prioritization of limited funding available to DIR, including LWDF funds, to meet its current obligations, which include implementation of recent legislation. Therefore, we recommend the Legislature postpone consideration of the Governor's proposal to fund $2.3 million in expanded education and outreach activities from the LWDF until it has considered the administration's proposal to reauthorize the LECF.

Staff Recommendation: Hold open.

Vote:

Issue 4 – Minors' Temporary Entertainment Work Permit Program (AB 1401; 2011)

Governor's Budget Request. The January budget requests increased expenditure authority of $583,000 (Entertainment Work Permit Fund-EWPF) and four positions in 2012-13, and $307,000 on-going, to comply with the requirements of Chapter 557, Statutes of 2011 (AB 1401), related to minors' temporary entertainment work permit program. Of the resources requested in 2012-13, $250,000 is one-time to create an on-line application and payment system.

Background. Current law (prior to enactment of Chapter 557) provides that minors aged 15 days to 18 years employed in the entertainment industry, must have written consent from the Labor Commissioner (known as an entertainment work permit) to perform work. These permits are issued for a period not to exceed six months. Eleven DIR staff working in district offices throughout the state issue the entertainment work permits. Permit applications are received over-the-counter and are also accepted via mail at all district offices. The current goal for turnaround on issuance of the permit from receipt is three working days. In 2010, DIR issued 60,361 entertainment work permits. The total cost of administering the current program is approximately $767,000 per year, for which DIR receives no specific revenue. The primary funding for existing workload is through the Labor Enforcement and Compliance Fund (LECF).

Effective January 1, 2012, Chapter 557 established an online permit approval process for the issuance of temporary work permits for minors working in the entertainment industry. Chapter 557 created the Entertainment Work Permit Fund into which permit fees received for a temporary entertainment work permit will be deposited and provides that these funds shall pay the costs to administer the temporary work permit program. Chapter 557 also authorized, on a one-time basis, borrowing and repayment of up to $250,000 from the LECF to the EWPF to pay for startup costs incurred in the creation of the program. The authorized fee level is sufficient to cover program costs up to $50 per application. The DIR reports that its conservative estimate determined that at least one-third of the 60,631 permits issued would start the process as a temporary permit using the new online application process. The resulting workload related to these 20,210 permits results in the four positions reflected in this request.

Staff Comment. Staff notes no concern with the programmatic specifics of this request, as it is consistent with the legislation that was approved by the Legislature last year. With regard to the budgetary resources requested, staff notes that the level of resources requested is beyond that which was estimated last year by the Appropriations Committees in their analysis of the bill. DIR indicated to staff that it regrets the discrepancies between the information initially provided to the Appropriations Committees and the resources contained in this request. Apparently communication breakdowns internal to DIR caused this to occur. DIR has assured both budget and fiscal staff that such discrepancies will not occur in the future.

Further, staff notes that while the implementation of the bill represents increased workload for DIR, it is not yet clear that the DIR estimate will prove correct yet the requested resources are permanent. 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.

Vote:

Issue 5 – Eliminate the Occupational Safety and Health Standards Board

Governor's Budget Request. The January budget requests to eliminate the Occupational Safety and Health Standards Board (OSH Board) and transfer responsibility to the Division of Occupational Safety and Health within the Department of Industrial Relations for half year savings of $324,000 (other funds) and two positions and on-going savings of $649,000 (other funds) and four positions beginning in 2013-14. This request includes proposed budget trailer bill language.

Background. The OSH Board, a seven-member body appointed by the Governor, is comprised of individuals from the areas of field labor, field management, field occupational health, field occupational safety, and the general public. The OSH Board is the standards-setting agency within the Cal/OSHA program. The OSH Board's objective is to adopt reasonable and enforceable standards at least as effective as federal standards. The OSH Board also has the responsibility to grant or deny applications for variances from adopted standards and respond to petitions for new or revised standards. The part-time, independent board holds monthly meetings throughout California. The members are not salaried, but receive $100/day per diem. The OSH Board has 15.9 staff and an operating budget of $2.4 million (mix of federal and special funds).

The Administration indicates that this proposal is part of its continuing effort to reduce the size of state government and create efficiencies. By eliminating the OSH Board, the Administration intends to model the state's approach to developing occupational safety and health standards after the federal approach for standards development, including stakeholder advisory panels. While the proposal technically eliminates the OSH Board, the proposed trailer bill language retains the Board's function in an Advisory Committee. The Administration asserts that modifying the OSH Board in this manner allows for a more streamlined operation, with reduced staffing levels, and no longer requires payment of stipends to board members, thereby achieving the savings figure identified above.

Staff Comment. This proposal is not new. Rather, it was proposed last year as part of a larger May Revision plan to make government more efficient by eliminating various boards and commissions. The final legislative action last year was to reject the elimination of the OSH Board.

Similar to last year, concerns have again been raised about the proposal, including: (1) The OSH Board's balanced representation requires regulations to be reached by consensus, yet the Administration's restructured proposal is silent how this process could be preserved using the proposed "advisory" board structure; and (2) The OSH Board is funded by an employer assessment and federal funds; the employer community has indicated their desire to continue paying for the OSH Board, as the Board's function and consensus process is of significant value. To staff's knowledge, the Administration has not developed a response to these concerns. More critically, staff is also unaware of any publicly presented concerns with the OSH Board's rulemaking process.

Staff Recommendation: Reject the elimination of the Occupational Safety and Health Standards Board and related trailer bill language.

Vote: