Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 5 Agenda

Senator Loni Hancock, Chair
Senator Joel Anderson
Senator Lois Wolk

May 23, 2012, at 1:30 p.m.
State Capitol, Room 3191

Consultants: Kris Kuzmich & Brady Van Engelen

MAY REVISE AND OPEN ISSUES

AGENDA PART A

OUTCOMES

(Please See Detailed Agenda on Pages 2 and 3 for Specific List of Issues to Be Heard)

Departments

0390	Contribution to the Judges' Retirement Fund
0820	Department of Justice
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
9650	Health and Dental Benefits for Annuitants
9800	Augmentation for Employee Compensation

Control Sections

3.60/3.61	Contribution to Public Employees' Retirement Benefits
3.90	Reduction for Employee Compensation
4.21	Health Care Premium Savings
31.10	Salary Savings

AGENDA – PROPOSED "VOTE ONLY" ITEMS

Please see summary chart on Page 4
Issue descriptions begin on Page 5

VARIOUS PUBLIC EMPLOYMENT AND RETIREMENT BUDGET ITEMS: TECHNICAL ADJUSTMENTS

OTHER DEPARTMENTS

AGENDA – PROPOSED "DISCUSSION / VOTE" ITEMS

Summary Chart of Issues Proposed for Vote Only:

	Issue	Amount	Fund Source	Staff Recommendation
	Public Employees' Retirement Fund (1900)			
1	Incorporate CalPERS Board Approved Budget into the Budget Act	Various increases and decreases	Public Employees Retirement Fund	Approve
	State Teachers' Retirement System (1920)			
2	Revised 2010-11 Creditable Compensation	$1.377 million	GF	Approve
	Health and Dental Benefits for Retired Annuitants (9650)			
3	Premium Increase for Retiree Health Care	$13.125 million	GF	Approve
	Augmentation for Employee Compensation (9800)			
4	Revised Cost Estimate for Allocation for Employee Compensation	$10.949 million $6.078 million	GF Other Funds	Approve
	Employment Development Department (7100)			
5	Unemployment Insurance Loan Interest Payment Amount Update	Decrease the loan to the GF by $104.4 million	Disability Insurance Fund	Approve
6	May Revision Updates, Unemployment Insurance, Disability Insurance, and School Employees Fund Adjustments	Various increases and decreases	Other Funds	Approve
7	Workforce Investment Act Adjustments	Various increases and decreases	Federal Funds	Approve w/modified BBL
	California Department of Human Resources (8380)			
8	Tribal Labor Panel	$100,000	Indian Gaming Special Distribution Fund	Approve

Staff Recommendation on vote-only items 1 through 8 approved by a vote of 2-0, with Senator Anderson absent.

Items Proposed for Vote Only – Issue Descriptions

Issue 1 – Public Employees' Retirement System (1900): Incorporate CalPERS Board Approved Budget into the Budget Act

Governor's Budget Request. In a May Revision Finance letter, the Governor requests various adjustments (both increases and decreases) to the CalPERS Board of Administration Budget to reflect the request by the CalPERS Board to incorporate its approved budget into the 2012-13 Budget Act.

Background. The annual budget act displays, for informational purposes only, the CalPERS' Board of Administration budget, as CalPERS' has continuous appropriation authority. The Governor's January budget includes the estimated CalPERS' Board of Administration budget for the upcoming fiscal year. On April 18, 2012, the CalPERS Board adopted a final budget. Adoption of this request will ensure that the final 2012-13 Budget Act will accurately reflect the CalPERS Board approved budget.

Staff Comment. Staff has no issues with this request. It represents a necessary technical adjustment to the January budget.

Issue 2 – California State Teachers' Retirement System (1920): Revised 2010-11 Creditable Compensation

Governor's Budget Request. In a May Revision Finance letter, the Governor requests an increase of $1.377 million GF, over the Governor's January budget level, due to an increase in the creditable compensation reported by the California State Teachers' Retirement System (CalSTRS) for fiscal year 2010-11, which increases the GF retirement contribution for fiscal year 2012-13.

Background. This May Revision proposal constitutes a technical correction regarding the amount of GF contribution to CalSTRS based on a revision of creditable compensation as reported for 2010-11. The true-up is a percentage-driven calculation and is the result of a lag in reporting of actual compensation. The January budget estimated 2012-13 contributions of $1.35 billion, based on an October 2011 report of prior-year teacher payroll by CalSTRS. The actual amount is based on the April 2012 submission by CalSTRS, which updated the prior-year teacher payroll.

This request represents a necessary technical adjustment to the GF CalSTRS payment for 2012-13. The budgeted payment amount consists of four separate components as dictated by state law. The revision in the creditable compensation results in a total increase in funding of $1.377 million. This increase consists of $545,000 in the Defined Benefit payment, $157,000 in the Pre-1990 Defined Benefit Level payment, and $675,000 for Supplemental Benefit Maintenance Account contribution.

Staff Comment. Staff has no issues with this request. It represents a necessary technical adjustment to the January budget.

Issue 3 – Health and Dental Benefits for Annuitants (9650): Premium Increase for Retiree Health Care

Governor's Budget Request. In a May Revision Finance letter, the Governor requests to increase by $13.125 million GF the statewide budget item for the costs of health and dental benefits for retirees to adjust for expected increases in health premium costs over the estimate contained in the Governor's January budget.

Background. The Governor's January budget included $1.7 billion ($1.662 billion GF) for the costs associated with providing health and dental benefits for retirees. The January budget projected an increase of 8.5 percent over the 2012 health premium rates, which translated to a $177.4 million ($172.8 million GF) year-over-year increase. The CalPERS' Board has not yet adopted the final rates, but the Administration indicates that the expected increase will actually be ten percent over the 2012 rates. This necessitates an adjustment to the January budget level to increase it by $13.125 million. If the final rate increase is ten percent, it would represent a total year-over-year increase of $190.5 million ($185.9 million GF). Final rates are not expected to be established until June 13, 2012.

Staff Comment. This is a necessary technical adjustment to the January budget level which underestimated the expected increase in health premium costs by 1.5 percent. Please see Issue 1 on Page 10 of this agenda for a proposed "discussion-vote" item related to health care premium costs.

Issue 4 – Augmentation for Employee Compensation (9800): Revised Estimate for Allocation for Employee Compensation

Governor's Budget Request. In a May Revision Finance letter, the Governor requests an increase of $10.949 million GF ($6.078 million other funds) over the Governor's January budget level to reflect revised estimates as a result of: (1) updated health care enrollment figures; (2) projected health care premium increases; (3) and updated salary surveys affecting the California Association of Highway Patrolmen (Bargaining Unit 5) and Judges.

Background. This statewide budget item allows for adjustments in departmental budgets to account for changes in employee compensation, including salaries and health and retirement benefits, based on a determination regarding the required funding levels.

With regard to health care, this request includes an adjustment for updated health care enrollment figures (over what was included in the January budget). Further, it includes an adjustment for projected health care premium increases. As noted in the immediate prior agenda item, health care premium rates are projected to increase by ten percent; the January budget was based on an 8.5 percent premium increase. Final rates are not expected to be established until June 13, 2012.

This request includes budget bill provisional language to ratify the addenda to extend the contract with Bargaining Units (BUs) 12 (International Union of Operating Engineers), 16 (Union of American Physicians and Dentists), 18 (California Association of Psychiatric Technicians), and 19 (American Federation of State, County and Municipal Employees) through July 1, 2013. This includes, for BUs 12 and 18, an adjustment to the 2012 health care premium rates on July 1, 2012, and the 2013 rates effective December 1, 2012.

Finally, and per current law, this request includes an adjustment for the updated salary surveys affecting BU 5 (California Association of Highway Patrolmen) and Judges.

Staff Comment. Staff has no issues with this request. It represents necessary technical adjustments to the January budget.

Issue 5 – Employment Development Department (7100): Unemployment Insurance Loan Interest Payment Amount Update

Governor's Budget Request. In a May Revision Finance letter, the Governor requests a decrease of $104.4 million in the amount of the interest payment due to the federal government for borrowing that has occurred to provide unemployment insurance (UI) benefits. This request effectively reduces the amount of funds to be borrowed from the Unemployment Compensation Disability Fund (DI).

Background. The January budget proposed an increase of $417 million GF to make the second interest payment due to the federal government for the quarterly loans that the EDD has been obtaining from the federal government since January 2009 to cover the UI Fund deficit (estimated at $9.8 billion at the end of 2011). To offset this GF expenditure, the January budget included a transfer from the DI Fund to the GF, resulting in no net GF cost in 2012-13. The federal government has since lowered the interest rate on funds borrowed, resulting in a decrease of $104.4 million. Therefore, as part of the May Revision, the Governor proposes to reduce the loan from the DI fund to the GF to $312.6 million.

Staff Comment. Staff has no concerns with this request as it represents a necessary technical adjustment to the January Budget. The Subcommittee approved the loan from the DI Fund to the GF Fund for the interest payment due to the federal government at its May 10, 2012, hearing.

Issue 6 – Employment Development Department (7100): May Revision Updates, Unemployment Insurance, Disability Insurance, and School Employees Fund Adjustments

Governor's Budget Request. In a May Revision Finance letter, the Governor requests to adjust funding for the new estimates of claims and payments for the Unemployment Insurance (UI) Program, the Disability Insurance (DI) Program, and the School Employees Fund, as follows:

- <u>UI Program and Benefit Adjustments</u>. An increase of $4.3 billion for UI benefits, due to the continuation of the federal benefits extension program. In addition, to accommodate increased benefit payments in the current year resulting from the federal extension, this request includes an increase of $895.7 million for UI benefits in 2011-12.

- <u>DI Program</u>. A reduction of $64.4 million to reflect a decrease in DI payments. Additionally, this request decreases DI benefit authority by $10.8 million in 2011-12.

- School Employees Fund (SEF). An increase of $19 million for benefit payments for the SEF, a joint, pooled risk fund administered by the EDD, which collects contributions based upon a percentage of total wages paid by public school and community college districts. Additionally, this request includes a decrease in benefit authority of $13.2 million in 2011-12.

Staff Comment. Staff has no issues with this request. It represents necessary technical adjustments to the January budget.

Issue 7 – Employment Development Department (7100): Workforce Investment Act Adjustments

Governor's Budget Request. In a May Revision Finance letter, the Governor requests a decrease of $55.3 million in federal Workforce Investment Act (WIA) discretionary funding. The decrease reflects changes in federal funding that have reduced state-level discretionary WIA funds from 15 percent of total statewide WIA funding to 5 percent. To reflect an increase in the level of local assistance funds available to states from 85 percent to 95 percent, the Governor requests an increase in WIA local assistance funding of $5 million in 2012-13 and $5.3 million in the 2011-12.

Background. Changes in federal law have dramatically reduced the amount of discretionary WIA funding available to the state for state-level discretionary programs and grants. Previously, local workforce investment areas received 85 percent of WIA funding, while the state received 15 percent. This amounted to $69.1 million in 2011-12. Under the new provisions, states only receive five percent of funds, which is estimated to be $20.5 million in 2012-13 for California. This reduced level of funding is only enough to cover state administrative costs and required federal auditing and oversight activities. This change at the federal level significantly limits the state's ability to fund statewide workforce development programs with these WIA funds.

Staff Comment. It is expected that there will again be a small amount of prior year savings available for reallocation in 2012-13. Therefore, the Subcommittee may wish to modify existing budget bill provisional language to incorporate any prior year savings into the October Revise, which is an annual update to the WIA program that is submitted to the Joint Legislative Budget Committee. This will ensure legislative consultation before these discretionary dollars are allocated for expenditure.

Issue 8 – California Department of Human Resources (8380): Tribal Labor Panel

Governor's Budget Request. In a May Revision Finance letter, the Governor requests an increase of $100,000 (Indian Gaming Special Distribution Fund-IGSDF) to provide funding for disbursement to the Tribal Labor Panel to support arbitration duties and other responsibilities pursuant to Government Code Section 12012.85(e).

Background. Under current law, the California Department of Human Resources (CalHR) is responsible to provide necessary funding for disbursement to the Tribal Labor Panel. The fund source is the IGSDF, which is money received by the state from Indian tribes as specified by the terms of the tribal-state compacts.

CalHR (formerly Department of Personnel Administration) first received $400,000 in funding from the IGSDF in the 2000 Budget Act. Since that time, and through 2010-11, these funds were used to contract with an outside entity to provide arbitration services per current law. Not all of the funds were used each year, leading to some funds disencumbering and reverting to the state. Additionally, these funds were reappropriated several times; the last reappropriation was in 2010-11. With this request, the Administration proposes to start fresh in 2012-13 and provide $100,000 from the IGSDF to CalHR for the Tribal Labor Panel. CalHR requires the appropriation so it can secure the contract; under the standard terms of the Budget Act, CalHR will have one year to encumber and two years to spend the funds.

Staff Comment. Staff has no issues with this request. Staff notes, however, that the Indian Gaming Special Distribution Fund could face solvency issues in 2013-14 which may limit any further appropriations for these purposes.

VARIOUS PUBLIC EMPLOYMENT AND RETIREMENT BUDGET ITEMS

Issues Proposed for Discussion / Vote

Issue 1 – California Public Employees' Retirement System (1900) and Health Care Premium Savings (CS 4.21): Elimination of Control Section 4.21

General 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 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.

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.

CalPERS reported that it achieved savings in 2011-12 of $46.7 million GF and $23.2 million other funds. These savings resulted 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, totaling $15.9 million GF and $4.0 million other funds. These cost avoidance savings were a result of such activities as Pharmacy Benefit Changes, Integrated Healthcare Model, and Service Area Expansion.

Governor's Budget Request. Via Budget Control Section 4.21 (CS 4.21), the Governor's 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. This request was held open at the Subcommittee's March 8, 2012, hearing as the Administration indicated that it was working with CalPERS and expected to submit additional proposals related to the health benefits program as part of the spring budget process.

May Revision Request. In a May Revision Finance letter, the Governor requests an increase of $45.4 million GF and $22.5 million other funds to reflect the elimination of Control

Section 4.21. The Administration indicates that CalPERS does not appear to have achieved the expected level of health care savings identified in CS 4.21 due to the significant year-over-year increase in anticipated health premium rates for 2013.

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 2011-12, CalPERS worked to pursue numerous strategies to achieve savings in the Health Benefits Program. However, even with these 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. The Administration now estimates that the 2013 health premium costs will grow year-over-year by ten percent.

Given this dynamic, it is understandable why the Administration requests the elimination of CS 4.21 as part of the May Revision. As the LAO has previously noted, any savings resulting from CS 4.21 likely would have to be achieved through CalPERS premium negotiations and that process is resulting in a ten percent increase in these costs. However, in considering this request, the Subcommittee may wish to query CalPERS about its efforts to reduce health premium costs. The 2011 Budget Act included statutory changes 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. At its March 13, 2012, meeting, the CalPERS Board considered a staff proposal to seek statutory changes to grant the Board the authority to: (1) adjust premiums as part of programs for health promotion and disease management; and (2) implement risk adjustment across plans to encourage health plan competition based on efficiency and quality rather than on population risk selection.

Staff Recommendation: Approve the May Revision request to eliminate CS 4.21.

VOTE: Staff Recommendation approved by a vote of 2-0, with Senator Anderson absent.

Issue 2 – Contribution to Employees' Retirement Benefits (CS 3.60 and 3.61): Various Technical Rate Adjustments

General Background. These control sections provide 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 sections hold departments' budgets harmless in the event of increases in employer CalPERS contribution rates and achieve budgetary benefit for the state when CalPERS contribution rates decline.

Governor's Budget Request. In a May Revision Finance letter, the Governor requests an increase of $202.063 million GF ($152.661 million other funds) for retirement rate adjustments. This includes increasing the California State University (CSU) base budget by $52.486 million GF to adjust it to the 2012-13 employer contribution rates.

Background. The Governor's January budget made assumptions regarding investment rates of return as well as retirement rates that have since been revisited and revised. The

May Revision provides necessary adjustments to these January estimates. The Administration indicates that the estimated increase in retirement costs are due to the following:

1. On March 14, 2012, the CalPERS Board voted to adopt a decrease in the assumed investment rate of return to 7.50 percent from 7.75 percent. This action resulted in higher estimated retirement costs in 2012-13 than were assumed in the January budget; of the total increases indicated above, this adjustment accounts for $304.161 million ($172.962 million GF) in additional costs.

2. In addition, due to factors beyond the assumed investment rate of return, the retirement rates are estimated to be higher than originally projected in the January budget; of the total increases indicated above, this adjustment accounts for $50.563 million ($29.101 million GF) additional costs.

However, the May Revision request notes that the retirement costs are not final and could change pending the adoption of the final 2012-13 retirement rates by the CalPERS Board of Administration on May 16, 2012. As a result of the $202.063 million GF adjustment, the fourth quarter payment to CalPERS (which was deferred to 2013-14) will increase by $50.516 million. The $202.063 million adjustment less the $50.516 million deferral results in a total net increase of $151.547 to the GF in 2012-13.

This request also includes amendments to CS 3.61 (which was proposed in the Governor's January budget) to allow for: (1) an incremental adjustment to CSU's base budget in 2012-13 for the change between 2011-12 and 2012-13 rates and (2) adjustments for the unfunded liability costs in 2013-14 and beyond. This part of this request will be considered by Subcommittee No. 1 on Friday, May 25, 2012. This Subcommittee will conform to the Subcommittee No. 1 action.

Staff Comment. The CalPERS Board voted on May 16, 2012, to set the state's required 2012-13 employer contribution at a level over the January budget that necessitates an increase of $124.23 GF ($93.622 million other funds). This level reflects the CalPERS Board action to phase-in the impact of the change in discount rate on the employer contribution rate by amortizing over a 20-year period the increase in the actuarial liabilities resulting from the change in assumptions. Under the phase-in, the payment in year one on the portion due to the change in the discount rate is equal to roughly 55 percent of the payment that would have been required without the phase-in and the unpaid balance amortized over the remaining 19 years at 7.5 percent interest. This will result in increased costs of $145.9 million GF ($110.7 million other funds) over the next 20 years. The CalPERS Board indicates the phase-in was adopted to provide employers with more time to adjust to the higher contribution rates.

Per the CalPERS Board action on May 16, 2012, the fourth quarter payment to CalPERS (which was deferred to 2013-14) will increase by $31.058 million. The $124.23 million adjustment less the $31.058 million deferral results in a total net increase of $93.2 million to the GF in 2012-13.

Staff Recommendation: Approve an increase of $124.23 million GF ($93.622 million other funds) over the January budget level in order to fund the state's required employer contribution to CalPERS in 2012-13.

VOTE: Staff Recommendation approved by a vote of 2-0, with Senator Anderson absent.

Issue 3 – Reduction for Employee Compensation (CS 3.90): Employee Compensation Reductions

General Background. This control section allows for adjustments in department budgets to account for changes in employee compensation, including salaries and health and retirement benefits, based on the determination of required funding levels.

Governor's Budget Request. In a May Revision Finance letter, the Governor requests to add CS 3.90 to the 2012-13 budget to authorize employee compensation-related reductions equivalent to a roughly five percent reduction in pay translating to savings of $401.7 million GF ($839.1 million all funds). This request includes both budget bill provisional language and budget trailer bill language.

Background. The total number of state employees is 341,783 resulting in a salary cost of $24.8 billion (all funds). This total includes employment in the Executive Branch, Judicial Branch, University of California, California State University, Hastings College of the Law, and Legislature. Roughly two-thirds of total state employment (214,254 employees) is in the Executive Branch. Of this total Executive Branch employment, about one-third is in the California Department of Corrections and Rehabilitation (CDCR). Compensation for salaries and benefits accounts for approximately 11 percent of GF costs, and includes $7.2 billion in salary expense and $3.3 billion in benefit costs. Employees of CDCR account for approximately two-thirds (64 percent) of GF salary costs.

The May Revision proposal is intended to achieve total savings equivalent to a roughly 4.62% percent reduction in pay (total of eight hours per work month). The proposed control section states that the savings will be achieved through: (1) the collective bargaining process, and/or (2) legislative reductions in the state workweek and changes in work schedules, and/or (3) furloughs, and/or (4) other reductions for represented and non-represented employees achieved through existing administration authorities. The Administration indicates its intent is to avoid a furlough program and to mitigate layoffs. To this end, the Administration states it will pursue the implementation of a four-day, 38-hour work week for the majority of state employees to achieve the necessary savings. The Administration suggests that this new workweek would allow the state to: (1) offer better services to the public by being open longer than the traditional 8-hour workday and (2) reduce energy usage in state-owned and leased buildings (any savings achieved from reduced energy usage is not included in the savings total).

The Administration states it will also pursue commensurate reductions in work hours and pay for employees of entities that operate 24 hours per day, seven days a week, when implementation of the four-day workweek is not feasible. These will be "variations" to the four-day 38-hour work week, as the Administration indicates that there will be no exceptions to the salary savings proposal.

Separately, the Administration indicates that it will continue to pursue changes to health coverage for active employees and retirees, to reduce costs for both employees and the state in the coming year. Any potential savings from these changes to health coverage remain unspecified and are not included in the above estimate; i.e., the $839.1 million is from salary savings only.

LAO Comment. Employee compensation, including salaries and benefits, will cost the state's GF $10.5 billion in 2012-13. Given the severity of the state's budget shortfall, the Legislature will need to consider reductions in these costs; however, there are no ideal ways to achieve such reductions. In addition to the issues related to a four-day workweek, including that it could increase leave balances and hinder services in many cases and may not reduce energy costs or be convenient for many, the Legislature should take into account the following issues when considering other alternatives to reductions in employee compensation costs: (1) bargaining typically necessitates concessions; (2) layoffs take months to achieve and can affect some services; (3) furlough and leave programs have future costs; and (4) non-negotiated state actions raise concerns.

Staff Comment. The Administration has indicated that its goal is to have a plan in place to achieve the savings by July 1, 2012, and is actively meeting with departments and labor officials to reach those agreements. At the time this agenda was written, the Administration had not yet transmitted the proposed budget trailer bill language associated with this request.

The five percent reduction could have an impact on revenue-generating activities of the Board of Equalization and the Franchise Tax Board. It would be important to structure any policy such that there would be flexibility to minimize or avoid revenue losses. The tax agencies are currently analyzing the proposal in light of this issue.

The Subcommittee may wish to consider holding this item open to allow time for more detailed information to be presented.

Staff Recommendation: Hold open.

Item Held Open.

Issue 4 – Salary Savings (CS 31.10): Salary Savings and Addition of Budget Bill Control Section 31.10

Governor's Budget Request. In a May Revision Finance letter, the Governor requests various modifications to adjust budget displays to reflect actual expenditures and eliminate the salary savings budget line item per Budget Letter 12-03. A department-by-department review of historic vacancies identified a total of 11,709 positions that will be permanently eliminated. This cost-neutral adjustment will accurately reflect department staffing levels and actual spending on personal services and operational expenses.

This request also includes: (1) a new budget bill control section to grant the Director of Finance authority to adjust positions if it is determined that subsequent adjustments to a department's position elimination total are necessary and (2) conforming changes to an existing budget bill control section CS 29.00, Personnel-Year Estimates of Governor's Budget, May Revision, and Final Change Book.

Background. All state departments have some vacant positions due to normal personnel turnover and hiring delays. In past decades, a typical state vacancy rate was about five percent; i.e., about five percent of authorized positions were vacant. According to the State Controller's Office, the current average vacancy rate is now about 15 percent and has hovered around that level for a number of years. Figure 1 on the next page displays that some departments have much higher vacancy rates. The Legislature authorizes positions so that departments may increase staffing levels to accomplish a specified activity. A high vacancy rate could mean that a department is not able to accomplish all intended activities or that the department has found ways to accomplish the activities without filling some positions (for example, by instead using overtime or contract personnel).

Figure 1: Vacancy Rates across Largest Departments

Department	Established Positions	Vacancy Rate (%)
Corrections	60,950	18.6
Transportation	20,989	6.6
Mental Health	11,429	13.1
Highway Patrol	11,254	7.8
Employment Development	10,099	18.9
Motor Vehicles	8,392	6.1
Developmental Services	5,957	15.7
Franchise Tax Board	5,394	11.6
Justice	4,936	21.8
CalFire	4,773	15.6
Board of Equalization	4,666	11.3
Social Services	4,494	21.0
Public Health	3,742	21.0
Health Services	3,331	18.4
Water Resources	3,112	7.8

Source: State Controller's Data

When a position is vacant or filled by an employee at a pay level lower than the department's budget assumes, the department captures "salary savings." Since the early 1940s, the state budget has assumed that most departments have "normal salary savings," historically assuming vacancies equal to about five percent of authorized personnel, and reduces departments' personnel budgets accordingly. (In other words, departments are not appropriated any funds for *normal* salary savings.) "Excess salary savings," or savings from vacant positions in excess of normal salary savings, typically can be used for personnel *or* operations expenditures but are displayed in a department's personnel budget.

Over the past decade or so, a number of decisions made by both the Administration and Legislature have contributed to high vacancy rates. The policies described below have created incentives for departments to generate excess salary savings by deliberately holding positions vacant.

- *Unallocated Cuts.* The Legislature has approved many unallocated cuts, especially to GF departments. When implementing unallocated cuts, the Administration chooses how to achieve the reduction. It is common for departments to hold positions vacant to absorb unallocated cuts. As a result, departments largely funded by the GF have noticeably higher vacancy rates than special fund departments.

- *Leave Cash Outs.* The number of state retirements has increased as employees of the baby boom generation reach retirement age. Upon retirement, the state must compensate (or cash out) an employee for certain unused leave days. Generally, departments do not receive supplemental appropriations to cover these costs. Some departments cannot absorb these costs without holding positions vacant.

- *Overtime Costs.* Some departments, especially those with 24–hour institutions, consistently incur high overtime costs. Like leave cash outs, departments sometimes do not receive supplemental appropriations for these costs. Departments with high overtime costs often have high vacancy rates to generate excess salary savings.

This request adjusts budget displays to more accurately reflect where costs are truly being incurred. For this reason, this request does not result in a change to appropriation authority. A statewide summary details the following as a result of this proposal: (1) decrease of 11,709.2 Authorized Positions and $1.1 billion in regular Salaries; (2) increase of 669.4 Temporary Help Positions and $137.2 million in Temporary Help funding; (3) increase of $62.6 million in Overtime funding; (4) increase of $6.0 million in Staff Benefits; (5) decrease of $55.0 million in Operating Expenses and Equipment; and (6) increase of $909.9 million to reflect the elimination of Salary Savings. These statewide totals reveal that money is generally moving from Operating Equipment & Expenses (OE&E) to personnel services. The Administration has provided two examples as explanation for this dynamic: (1) departments have been using OE&E money to fund authorized positions that were not funded and/or (2) departments have been keeping positions vacant (above the budgeted salary savings rate) to fund higher-paid positions, benefits, overtime, temporary help, or OE&E.

LAO Recommendation. The Administration should more fully develop its proposal and, if resubmitted later, it should be fully vetted by the Legislature over at least several months in some future year. While the proposal seemingly would have no effect on the number of people currently employed by the state or the amount of money spent by departments, it could result in staffing levels far different from the priorities of the Legislature. The proposal apparently would contribute nothing to balancing the 2012–13 budget. Therefore, the LAO recommends that the Legislature reject the Governor's proposal now and suggest that the Administration may choose to submit detailed proposals in the future justifying why vacant positions should be eliminated and how this new position budgeting process would work in future years. Legislative review of such a proposal would require extensive time of legislators and staff.

Staff Comment. This request is intended to eliminate budgeted salary savings and allocate that amount to accurately reflect how state operations funds are being expended. It will eliminate a large number of vacant authorized positions, which were unfunded positions as a result of normal salary savings. It will also ensure the budget no longer reflects salary savings, but rather department budgets for personnel and operations will be closer to reflecting actual costs in those areas. Finally, it holds departments harmless, as the total amount budgeted to a given department is not affected by this proposal. This request will make the budget more transparent, particularly to the public.

Staff Recommendation: Approve the May Revision request, including conforming changes to CS 29.00.

VOTE: Staff Recommendation approved by a vote of 2-0, with Senator Anderson absent.

Issue 5 – Addition of New Budget Bill Control Section: Government Code Section 19826 Salary Adjustments

Background. In 2006, the supervisory division of the California Association of Professional Scientists (CAPS) requested a quasi-legislative hearing alleging the Department of Personnel Administration (DPA, now California Department of Human Resources) was violating Government Code Section 19826 because fourteen supervisory scientist classifications were performing similar work as certain engineering supervisors and should be paid similar salaries. DPA held a quasi-legislative hearing and, on April 28, 2008, DPA issued a decision recommending salary increases for the fourteen supervisory scientist classifications. DPA has been restricted from implementing the necessary salary increases because there were no existing appropriations to fund the increases. Government Code Section 19826 only permits DPA to adjust salaries where there is an existing appropriation to fund the increase.

Since that time, CAPS initiated litigation, *CAPS v. DPA, et al*, against DOF and DPA to mandate payment of the salary increases. The trial court found DPA has an obligation to present the salary information to DOF for inclusion into the Governor's proposed budget and that DOF is obligated to present the information to the Legislature.

In May 2011, the Court of Appeal held that DOF does not have "a ministerial duty to seek an appropriation to fund salary adjustments approved by DPA." Instead, Section 19826, the court said, "imposes duties only on DPA", by (1) requiring "DPA to adjust salaries based on the principle that like salaries be paid for like work" and (2) prohibiting "DPA from adjusting salaries to the extent funds for new salaries have not been appropriated." The Court also held that "any additional appropriations" to fund such adjustments "are within the discretion of the Legislature and the Governor as they craft a budget." "They can choose," the court said, "to reject proposed salary adjustments despite Section 19826." In addition, the court said DOF needed "to submit to the committees in the Assembly and Senate which consider appropriations and to the Joint Legislative Budget Committee 'copies of budget materials submitted to it' by state agencies for Finance's approval."

The fourteen classifications impacted by the DPA decision are spread among 19 different state departments, primarily in the resources area, including the Departments of Fish and Game, Water Resources, Toxic Substances Control, Parks and Recreation, and the Water Resources Control Board. In total, the salary adjustments comprise $10.2 million, of which $1.6 million is GF.

Staff Comment. In examining this "like pay-like work" salary adjustment, several factors warrant the Subcommittee's consideration. CAPS pursued the current statutory process which resulted in a favorable decision yet has not resulted in the salary adjustments being made. While it could be argued that result points to a need to change statute, the dynamic remains that under the State Constitution the Legislature has the sole authority to appropriate funds. This salary adjustment has never been included in a Governor's January proposed budget. If it were to be included, it would be the Legislature's choice to adopt or reject any proposed salary adjustments despite Section 19826. In the same vein, the Legislature can choose to add the salary adjustment as it considers the Governor's proposed budget. Another potential concern is that adopting this salary adjustment for these supervisory positions could open the door to additional requests from other supervisory classifications for quasi-legislative hearings before DPA. Adoption could also increase wage pressure to increase salaries for rank and file CAPS members. However, and per current law, those salary increases would be subject to collective bargaining. In the end, and after having been presented with the salary adjustment information, it is a choice of the Legislature whether to provide the appropriation necessary to implement salary increases under Section 19826.

Staff Recommendation: Approve a new budget bill control section to appropriate the funds necessary to adjust salaries for the fourteen supervisory scientist classifications per Government Code Section 19826.

VOTE: Revised Staff Recommendation to add the funds to Item 9800 with provisional language to clarify the purpose of the funds approved by a vote of 2-0, with Senator Anderson absent.

CALIFORNIA DEPARTMENT OF JUSTICE (0820)

Departmental Overview. The constitutional office of the Attorney General, as chief law officer of the state, has the responsibility to see that the laws of California are uniformly and adequately enforced. This responsibility is fulfilled through the diverse programs of the Department of Justice (DOJ).

The DOJ is responsible for providing skillful and efficient legal services on behalf of the people of California. The Attorney General represents the people in all matters before the Appellate and Supreme Courts of California and the United States; serves as legal counsel to state officers, boards, commissioners and departments; represents the people in actions to protect the environment and to enforce consumer, antitrust, and civil laws; and assist district attorneys in the administration of justice. The DOJ also provides oversight, enforcement, education, and regulation of California's firearms/dangerous weapons laws; provides evaluation and analysis of physical evidence; regulates legal gambling activities in California; supports the telecommunications and data processing needs of the California criminal justice community; and pursues projects designed to protect the people of California from fraudulent, unfair, and illegal activities.

Issues Proposed for Discussion / Vote

Issue 6 – Crime Statistics Reports

Governor's Budget Request. The Governor's 2012-13 budget includes a request via trailer bill language to suspend and repeal the requirements in this mandate program that remain in statute.

Background. Currently, the state must reimburse local governments for costs associated with fulfilling reporting requirements. Specifically, some, or all of, the cost of reporting hate crimes, homicides, and domestic violence by local agencies are reimbursable. A reporting requirement to the DOJ regarding certain demographic information about persons charged with specified firearms offenses has been repealed. Furthermore, all of the above mandates minus the firearms report, which was repealed in 2005, are currently in suspense.

According to the State Controller's Office (SCO), the requirement to produce domestic violence incident reports represents the vast majority of the total cost of the combined mandate. Based on SCO's claims data, it is estimated that about $144 million of the $146 million accrued cost through 2010-11 is associated with domestic violence incident report requirements, as is about $17.2 million of the $17.4 million annual in ongoing costs.

LAO Recommendation. The LAO has recommended that the Legislature make several changes to the Governor's proposal related to this mandate. They have recommended that the Legislature maintain the two requirements related to the reporting of hate crime and homicide statistics. Because some federal funds that come to the state—including grants made directly to local entities—may be jeopardized if some local agencies do not report these statistics, and given that they represent a relatively modest state cost, it is their belief that it is in the best fiscal interest of the state to maintain these requirements. They have noted that the Legislature could make optional, rather than delete, the requirement that local law enforcement agencies produce domestic violence incident reports, thereby eliminating this state-reimbursable mandate.

Additionally, the LAO has suggested not deleting other sections of the domestic violence reporting statutes that would be deleted under the Governor's proposal. Rather, maintaining the requirement that DOJ report domestic violence statistics (which is not a state-reimbursable mandate), and making optional the provisions related to collection and reporting of domestic violence-related information.

Specifically, the LAO has recommended:

- Modifying the Governor's proposed trailer bill language to: (1) leave intact the hate crime and homicide reporting requirements, (2) make optional the requirements related to producing a written incident report for each domestic violence-related call for assistance, (3) make optional the requirements that local law enforcement record certain information related to these calls and report domestic violence statistics to DOJ, (4) leave intact the requirement that DOJ report domestic violence statistics, and (5) direct the Commission on State Mandates to modify its parameters and guidelines for this mandate program to allow local governments to submit future claims only for the hate crime and homicide reporting requirements that would not be eliminated under our proposal.

- Modifying budget bill language to (1) suspend just the portion of this mandate specifically related to the domestic violence incident reports and (2) augment Item 8885-295-0001 by $1.8 million to pay the costs accrued through 2010-11 associated with the hate crime and homicide reporting requirements that would not be repealed under this proposal.

Staff Comment. There have been a number of stakeholders in the state that have identified the reports as a valuable source of information in identifying crime trends in the state. Furthermore, as noted by the LAO, these federal funds could be subject to the reporting of the information specified in this request.

Staff Recommendation. Adopt the LAO recommendation.

VOTE: Staff Recommendation approved by a vote of 2-0, with Senator Anderson absent.

Issue 7 – Abbott Laboratories Settlement

Governor's Budget Request. The Governor's May Revise includes a request to transfer $7.7 million dollars from the False Claims Act fund to the GF.

Background. The DOJ, along with the federal government and the Department of Health Care Services, negotiated a settlement with Abbott Laboratories that will provide up to $7.7 million for deposit into the False Claims Act Fund. It is expected, that, in total, the state will receive approximately $30.7 million in the settlement. A portion will benefit the GF through Medi-Cal, and the remainder will be deposited into the False Claims Act Fund, which will also benefit the GF.

The consumer protection settlement provides the state with the funds. In the complaint, it was noted that Abbott Laboratories had engaged in unfair and deceptive practices when it marketed one of its products, Depakote, for off-label uses. The drug Depakote is approved for treatment of seizure disorders, mania associated with bipolar disorder and prophylaxis of migraines, but the attorneys general alleged Abbott Laboratories marketed the drug for treating unapproved uses, including schizophrenia, agitated dementia, and autism.

Staff Recommendation: Approve May Revise request.

VOTE: Staff Recommendation approved by a vote of 2-0, with Senator Anderson absent.

Issue 8 – DNA Identification Fund

Governor's Budget Request. The Governor's May Revise includes a request that item via trailer bill language that Government Code section 76104.7 be amended in order to add $1 to the DNA penalty assessment. Additionally the May Revise has requested that Item 0820-011-0001 be eliminated.

Background. On November 2, 2004 California voters overwhelmingly passed Proposition 69, the DNA Fingerprint, Unsolved Crime and Innocence Protection Act. Under this initiative any person convicted of a felony offense, plead to a misdemeanor sex offense, and/or was arrested for violent felony or sex crimes is now eligible for inclusion in the Forensic DNA Identification Database. Originally, under Proposition 69, an additional penalty of $1 is levied for each $10 fraction thereof, upon every fine, penalty, or forfeiture collected by the courts for criminal offenses. Additional adjustments have been made to Government Code Section 76104.7 levying $3 for every ten dollars, or part of ten dollars. The May Revise requests that the three dollar amount be struck from Government Code Section 76104.7 and that four dollars be inserted in its place, essentially adding one dollar to the current penalty assessment.

Also included in this request was the call to remove Item 0820-011-0001. This specific item authorized the Controller, upon order of the Director of Finance to transfer funds to the DNA Identification Fund. By increasing the amount levied against individuals specified above the need for a transfer from the General Fund to this account will not be necessary.

Staff Comment: Staff has no issues with this request.

Staff Recommendation: Approve May Revise Request.

VOTE: Staff Recommendation approved by a vote of 2-0, with Senator Anderson absent.

Issue 9 – National Mortgage Settlement Agreement

Background: On April 19th the Senate Budget and Fiscal Review Subcommittee No. 5 heard the National Mortgage Settlement agreement as a discussion item as no details on the discretionary funds associated with the settlement were available. Subsequently, the Administration has submitted a May Revise that would specify where some of the $410 million in the discretionary award will be allotted. As noted in the April 19th Senate Budget and Fiscal Review Subcommittee No. 5 hearing agenda, amounts awarded to consumers, local agencies, and the state are identified below:

- $12 billion will be dedicated to reduce the principal balance on loans by offering either affordable modifications or short sales to approximately 250,000 California homeowners.
- $430 million payment in penalties, costs, and fees.
- $849 million to help refinance the loans of approximately 28,000 California homeowners with interest rates above 5.25 percent who are current on their mortgage payments but underwater on their loans.
- $279 million will be dedicated to provide payments to approximately 140,000 homeowners foreclosed upon during the worst period of servicing misconduct.
- $1.1 billion will be distributed to California communities to repair blight and devastation left by waves of foreclosures in hard-hit areas.
- $3.5 billion to forgive unpaid debts to banks for about 32,100 homeowners who have lost their homes to foreclosure.

The Governor's May Revise via trailer bill language identifies where a portion of the $410.6 million in discretionary funds will be spent in 2012-13. According to the proposed trailer bill language, for 2011-12 and 2012-13, $94.2 million of the settlement will be utilized to offset GF contributions that support public protection, consumer fraud enforcement and litigation, and housing related programs. Specifically, the funds will be utilized for the following programs in 2012-13:

- $41.1 million paid as a civil penalty into the Unfair Competition Law Fund to offset the costs of the various Department of Justice Programs.
- $44.9 million to support the Department of Justice's Public Rights and Law Enforcement programs relating to public protection and consumer fraud enforcement and litigation.
- $8.2 million for the Department of Fair Employment and Housing. This will offset a portion of the General Fund contribution made to the Department; the contribution from this settlement reflects the housing related portion of the Department's workload.
- $198 million will be set aside to offset GF costs for housing bond debt service for those programs funded with Proposition 46 and Proposition 1C housing bonds that assist homeowners.

The remaining funds ($118.4 million) will be set aside for use in the 2013-14 budget for similar purposes.

Staff Recommendation. Leave this item open.

Item Held Open.

VARIOUS LABOR BUDGET ITEMS

Issues Proposed for Discussion / Vote

Issue 10 – Employment Development Department (7100): Disability Insurance Automation Project

Governor's Budget Request. An April 1 Finance Letter requests a one-time augmentation of $33.787 million (Disability Insurance Fund-DI Fund) to fund a net of 68 positions to support the fourth year of development, testing, and implementation of the Disability Insurance Automation (DIA) project.

<u>This request was first heard by the Subcommittee on May 10, 2012. It was held open pending receipt of Administration responses to questions raised at the hearing</u>.

Background. The DIA project was initially funded in the 2006 Budget Act. The DIA project will provide 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 will simplify and automate the numerous manual work processes involved when a Disability Insurance (DI) claim is filed with EDD. Further, scanning/optical character recognition will be 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 DIA project is scheduled to "Go Live" in summer 2013.

Of the positions contained in this request, 27 are new positions, 70 are existing positions, and 29 positions were eliminated due to a reduction in Key Data Operators, for a net of 68 positions. 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 DI branch employees, thus saving on the amount of staff required to administer the program.

Staff Comment. The resources in this request are consistent with Special Project Report (SPR) 3, which was approved by the Technology Agency in November 2011. SPR 3 reflects a number of changes relative to SPR 2, including the project end date being extended from August 2012 to June 2013 and scope changes to provide for an interface with the Single Client Database (SCDB) DB2 system. These changes are necessary, particularly with regard to the interface with the SCDB. As of November 2011, EDD is operating in a DB2 database platform environment, so it is necessary to revise the DIA project to ensure compatibility between the DI system and the main EDD database.

SPR 3 also reflects a variance of $38.6 million (DI Fund) over SPR 2. While this is an accurate figure, it is potentially misleading given the extension of the project completion date. In addition, SPR 3 includes two years of *possible* additional vendor support. The more meaningful figure is that one-time costs increased by $6.1 million and annual support costs increased by $2 million once the project is fully implemented. Additionally, should EDD become vendor independent sooner than expected, the additional resources may not be required.

On the point of vendor independence, staff notes that EDD is in a difficult position. As the Subcommittee is aware, EDD has simultaneously pursued a number of large information technology projects. Through various budget actions, the Legislature supported these myriad efforts to modernize EDD's operations. As the projects, including DIA, collectively reach completion, EDD faces a challenge to acquire, train, and deploy sufficient state staff resources to transition to support of the projects and terminate its need for vendor support. In this vein, the Technology Agency has required EDD to provide an enterprise wide resource plan by January 31, 2013, outlining how EDD will provide sufficient state resources to these projects.

Staff Recommendation: Approve the April 1 Finance Letter.

VOTE: Staff Recommendation approved by vote of 2-0, with Senator Anderson absent. EDD shall provide to the Subcommittee a one page summary of the expected benefits of this information technology project.

Issue 11 – Employment Development Department (7100): Unemployment Insurance Modernization (UIMOD) Continued Claims Redesign Project

Governor's Budget Request. In a May Revision Finance letter, the Governor requests a one-time budget augmentation of $16.9 million (including $11.6 million EDD Contingent Fund and $5.3 million Unemployment Fund) and a redirection of $6.3 million Unemployment Administration Fund (UI Admin Fund) for the UIMOD Continued Claims Redesign (CCR) Project. The requested increase will fund 47 existing positions, hardware purchases, project management and other consultant costs, Independent Verification and Validation services, Independent Project Office Coordinator services, and an increase to the prime vendor services contract.

Background. First authorized in the 2003 Budget Act, the Call Center Network Platform and Application Upgrade (CCNPAU) and CCR subprojects are intended to modernize unemployment insurance (UI) services. In May 2006, the EDD submitted a Special Project Report (SPR) that proposed to merge the two subprojects due to multiple interdependencies. This necessitated refining the scope, schedule, and costs of the combined projects.

The CCNPAU subproject built a single network infrastructure for EDD's 15 call centers to interact with an intelligent call routing system, thereby reducing call blockage and improving access to services at EDD's call centers, to meet federal Department of Labor performance guidelines. This project increased the number of available agents by 1,000 and provided the infrastructure necessary to route calls to specialized agents. The CCNPAU project was completed in May 2011.

The CCR subproject will develop an interactive Internet Web site and telephone application that allows customers to file UI claims and recertify on a bi-weekly basis on the Web or by phone. Customers will be able to confirm certification, reopen claims, submit address changes, and receive communications via this application. This solution reduces the amount of workload that must be processed. SPR 4 for the CCR project was approved by the Technology Agency on April 18, 2012. The CCR project is scheduled for "go live" implementation in August 2013.

Staff Comment. SPR 4 reflects a variance of $30 million over the prior SPR. Of these costs, $11 million is attributable to the CCNPAU project. While this project was completed in May 2011, funds were spent to incorporate an identity management solution and additional call center agent seats and equipment due to unprecedented workload increases. The remaining $19 million is attributable to the CCR project. As with the DIA project, two additional years of *possible* additional vendor support are included, resulting in $10 million for extending current contracts, equipment, data center services, hardware, software, and state staff. Should EDD become vendor independent sooner than expected, the additional resources may not be required. The remaining $9 million is due to the need to update this project to provide for an interface with the Single Client Database DB2 system. Again similar to the DIA project, these changes are necessary. As of November 2011, EDD is operating in a DB2 database platform environment, so it is necessary to revise the CCR project to ensure compatibility with the main EDD database.

Staff also notes that the funds included in this request, which are completely necessary to cover the costs for the final year of work to complete this project, do involve trade-offs. This request includes both EDD Contingent Fund and redirected UI Admin Fund dollars. The Contingent Fund is GF-fund fungible. The use of the Contingent Fund in this manner is self-evident; these funds would otherwise be available for GF purposes. The UI Admin Fund are federal dollars provided to the state in support of the costs to administer the UI program. The redirection of $6.3 million from the UI Admin Fund for the CCR project will result in approximately 284,000 fewer calls that will be answered on an annual basis, 88,000 claims filed by phone, the Internet, and paper or fax would be processed untimely, and 100,000 eligibility determinations appointments would be scheduled untimely on an annual basis. While these trade-offs are not desirable, they are necessary as it is not an option to abandon the CCR project which is in its final 12 months. The CCR project will also result in more services becoming available to the public as “self-service” without any staff interventions. This will generate more efficiencies allowing staff to be redirected to serve customers who are not computer or on-line users. The CCR project will also assist EDD is its ongoing challenges with inadequate federal UI Admin funds (California receives $98 million, or 22 percent less, than needed to fully fund the actual costs to administer the UI program).

On the point of vendor independence, and as with the DIA project, staff notes that EDD is in a difficult position. As the Subcommittee is aware, EDD has simultaneously pursued a number of large information technology projects. Through various budget actions, the Legislature supported these myriad efforts to modernize EDD’s operations. As the projects collectively reach completion, EDD faces a challenge to acquire, train, and deploy sufficient state staff resources to transition to support of the projects and terminate its need for vendor support. In this vein, the Technology Agency has required EDD to provide an enterprise wide resource plan by January 31, 2013, outlining how EDD will provide sufficient state resources to these projects.

Staff Recommendation: Approve the May Revision request. Note, this request includes a conforming action to approve a May Revision request in Budget Item 0530, Office of System Integration (OSI), Health and Human Services Agency, to reduce OSI spending authority in both 2011-12, 2012-13, and 2013-14 to align the authority with the remaining project costs identified in SPR 4 for the CCR project.

VOTE: Staff Recommendation approved by a vote of 2-0, with Senator Anderson absent. EDD shall also provide to the Subcommittee a copy of the January 31, 2013, report required by the Technology Agency.

Issue 12 – Department of Industrial Relations (7350): Implementation of 2011 Legislation, 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.

May Revision Request. In a May Revision Finance letter, the Governor requests to instead implement these statutory changes with fund support from the Labor and Workforce Development Fund.

The Labor and Workforce Development Fund (LWDF) was expected to have a fund balance of $8.7 million in 2012-13; these requests would use a total of $2.5 million from that fund. The LWDF is established in Labor Code Section 2699 and is a repository for funds awarded through civil actions by employees against employers. The fund is intended to be used by the Labor and Workforce Development Agency to enforce labor laws and educate employees and employers about labor laws.

Staff Comment. The May Revision proposal to support these workload requests from the LWDF responds to concerns raised by the Subcommittee when the requests were initially heard on March 8, 2012. The concerns centered on the fact that the Labor Enforcement Compliance Fund is only authorized until June 30, 2013; therefore, it would be difficult for the Subcommittee to fund a permanent workload request on a fund source with a quickly impending sunset. With the May Revision change, staff notes no concern with the requests. The fund source question has been satisfactorily resolved. The programmatic specifics of these requests are consistent with the legislation that was approved by the Legislature last year and staff concurs with the Administration's finding that implementation of Chapters 677 and 706 will result in increased workload for the Department of Industrial Relations.

Staff Recommendation: Approve the budget requests, as modified by the May Revision, to utilize the Labor and Workforce Development Fund as the fund source to support implementation of the requests.

VOTE: Staff Recommendation approved on a five-year limited-term basis by a vote of 2-0, with Senator Anderson absent. Subcommittee also adopted SRL requiring DIR to provide a report by January 10, 2017, of workload and outcomes related to implementation of SB 459.

Issue 13 – Department of Industrial Relations (7350): 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.

This request was initially heard on March 8, 2012. It was held open due to uncertainty regarding the availability of future funding from the Labor Enforcement Compliance Fund (LECF), which may necessitate prioritization of limited funding available to DIR, including LWDF funds, to meet its current obligations, including implementation of recent legislation.

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. This request utilizes 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 LWDF. Currently, DIR does not receive an appropriation from this fund. Since its inception, the fund has been underutilized with revenue outpacing annual expenses.

Staff Comment. The Administration has affirmed that the resources in this request will not overlap or otherwise duplicate prior efforts. It will also build on lessons learned from prior outreach campaigns, such as that billboard and radio ads are the most effective communication tool. 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 data will be collected, the Subcommittee may to consider adding a report by March 10, 2013, requiring DIR to provide an update about the status of the implementation of this effort to increase the overall efficacy of statewide enforcement of labor laws.

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.

Staff Recommendation: Approve the request with supplemental report language requiring the DIR to report to the Legislature by March 10, 2013, as to the status of the implementation of this effort to increase the overall efficacy of statewide enforcement of labor laws.

VOTE: Staff Recommendation approved by vote of 2-0, with Senator Anderson absent.