



## Legislative Fiscal Bureau

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May 17 , 2007

Joint Committee on Finance

Paper #173

### Compensation Reserves Overview (Budget Management and Compensation Reserves)

#### *Bill Item*

[LFB 2007-09 Budget Summary: Page 66, #1]

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#### **CURRENT LAW**

For the 2005-07 biennium, all funds compensation reserves totaled \$227,696,800 in 2005-06 (\$90,054,100 GPR and \$137,642,700 Other Funds) and \$450,828,800 in 2006-07 (\$178,302,800 GPR and \$272,526,000 Other Funds).

#### **GOVERNOR**

Provide, in the 2007-09 general fund condition statement, total compensation reserves of \$143,311,400 in 2007-08 and \$366,427,900 in 2008-09 for increases in state employee salaries and employer fringe benefit costs. Under the Governor's recommendations, total compensation reserve amounts by fund source and fiscal year are as shown in the following table:

#### **SB 40 Compensation Reserves**

<u>Fund Source</u>	<u>2007-08</u>	<u>2008-09</u>
GPR	\$67,784,500	\$172,546,700
FED	36,589,600	93,760,400
PR	20,454,900	52,569,300
SEG	<u>18,482,400</u>	<u>47,551,500</u>
TOTAL	\$143,311,400	\$366,427,900

## **DISCUSSION POINTS**

This paper is for informational purposes only and provides no modification of, or alternatives to, the bill.

1. The purpose of establishing compensation reserves is to indicate that monies are reserved in the budget to provide funding for increases in state employee salaries that will subsequently be provided to state employees, but for which funding is not included in individual agency budgets as a part of the biennial budget. In other words, these reserves are, in part, for employee pay increases that will be provided in the 2007-09 fiscal biennium and that will ultimately be paid as salary expenditures from agency budgets, just as employees' current salaries are financed. However, funds are not allocated at the time of budget development to individual agency budgets because neither the amount of any salary increases nor the specific amount of funding needed by each individual agency is known at the time of budget development. These will be set later in the biennium as a result of compensation plan and collective bargaining agreements that are approved for the 2007-09 biennium.

2. The funding levels provided within compensation reserves are intended to cover the increased employer salary and associated fringe benefit costs resulting from any compensation plan increases for non-represented employees and UW faculty and academic staff that are recommended by the Office of State Employment Relations (OSER) and approved by the Joint Committee on Employment Relations (JCOER). In addition, funds must be reserved to pay for the costs of salary and associated fringe benefit costs that will be provided to represented state employees under collective bargaining agreements covering the state's 19 established bargaining units that are approved for the 2007-08 biennium. Also, premium levels for state employee health insurance are determined in the fall of each year to become effective the following January. The employers' share of any such premium increases are also not included in agency budgets for those January increases since the amount of any such increases are also not known at the time of budget development. Therefore, funds must also be included in compensation reserves for the expected increases in the employers' share of the costs of increased premiums for state employee health insurance.

3. Thus, in the 2007-09 biennium, all of these categories of costs will likely have to be funded from the compensation reserves pool under the pay plan supplements process. The pay plan supplements process operates as follows. The Department of Administration (DOA) requires state agencies, towards the end of each fiscal year, to document their need for any supplementation of their existing budgets for the cost of any authorized pay increases (including associated fringe benefit costs such as social security and retirement contribution payments) provided to the agencies' employees and for the cost of the employers' share of any increased premiums for state employee health insurance. Once these requests have been reviewed by DOA, they must then be submitted to the Joint Committee on Finance for final approval under a 14-day passive review process.

4. The schedule of compensation reserves within the condition statement section of the budget indicates reserve funding for each of the funding sources from which state employees' salaries may be funded. The respective indications of GPR, PR, FED and SEG funding amounts are

included to provide an indication of the all funds impact of the anticipated cost increases to agencies under the administration's compensation plans. However, the actual fiscal impact of "releasing" funds from these indicated reserves is quite different between GPR funds and all the non-GPR funding sources. The reason for this is that the GPR funding comes from a single central source, the general fund which is composed primarily of general tax revenues. In contrast, the other funding sources are not actually all pooled in a single account. While these revenue sources are the same in the definitional sense of involving the same type of revenue (for example, federal revenues), the revenues are actually retained by the individual agencies in either separate program accounts (such as a separate program account for licensing fees) or in distinct segregated funds (the transportation fund or the conservation fund, for example). Therefore, rather than these different revenues all going to a single fund, each program account or segregated fund separately receives revenues that are to be deposited exclusively in that account or fund and the expenditures of those revenues may be made only for the purposes authorized for that account or fund.

5. As a consequence of this difference, when GPR that is set aside in the compensation reserves is released to state agencies under the pay plan supplement process, it is transferred from one central GPR appropriation to individual agency GPR appropriations for actual expenditure. In contrast, when PR, SEG or FED monies are "released" to state agencies under the pay plan supplement process, these monies are transferred from the individual revenue balance of the particular account or fund for that individual agency to the appropriation side of that account or fund. In general, such accounts or funds usually have sufficient revenue reserves to cover the pay plan supplements costs; what they need is the authorization to increase their total spending authority by the amount of the requested supplement.

6. The review of compensation reserves is therefore usually viewed in terms of GPR funding levels. As indicated in the table on page 1, GPR compensation reserves in SB 40 total \$240,331,200 (\$67,784,500 in 2007-08 and \$172,546,700 in 2008-09). Funding needs for approved salary increases, and for increases in the employers' share of health insurance costs and in other fringe benefit costs, would be expected to fall proportionately on the other fund sources in a similar manner, since the increases for a given employee do not differ based on the funding source for that employee's salary. For example, if all employees are granted a 2% salary increase, that increase is paid to each eligible employee, whether the employee is funded from GPR funding or from other fund sources.

7. Given these factors, the balance of this paper will discuss projections for the GPR share of compensation reserves.

8. Neither the Department of Administration (DOA) nor the Office of State Employment Relations (OSER) has provided any details on the cost component items included within the compensation reserves amounts provided in SB 40. OSER officials indicate that any specific allocation of these reserve funds is subject to collective bargaining and therefore they could not comment in detail on the potential use of these funds. In addition, it was stated that providing further detail on the precise assumptions related to the components of the compensation reserve would seriously jeopardize the state's bargaining position with the state employee unions and that

this position is consistent with past administration policies. OSER maintains that this policy protects the state's position at the bargaining table and enables the administration to settle contracts that meet the needs of both the state and its unions.

9. The administration has not yet submitted to JCOER its recommendations for the compensation plans for non-represented employees and for UW faculty and academic staff. Therefore, it is not known at this time what recommendations will be included in those plans for across-the-board (ATB) increases effective for fiscal years 2007-08 and 2008-09. These compensation plans provide an important context for subsequent collective bargaining negotiations with represented state employees.

10. Based on past practices, the compensation reserve amounts will likely include funding for at least the following potential cost components: (a) funds for the employer share of state employee health insurance premium increases in the forthcoming fiscal biennium; (b) funds for the cost of ATB pay increases that will be provided pursuant to compensation plans and collective bargaining agreements for the 2007-09 biennium, but that have yet to be approved; and (c) possibly, funds for market adjustments or classification surveys for certain employee classifications that are judged as a group or subset to be below comparable salaries outside state government.

11. The employer share of state employee health insurance costs comprise a significant portion of the compensation reserves. It is possible to make an estimate of these increased costs based on assumed percentage increases in: (a) the premium costs for state employee health care coverage in the 2007-09 biennium; and (b) the required employee contribution levels made to cover a share of health insurance premium costs.

12. The DOA 2007-09 budget instructions to agencies, relating to the calculation of health care reserves to be included in all program revenue and segregated appropriation accounts that have authorized positions, specified that annual premium increases of 10% should be assumed. Based on discussions with the Department of Employee Trust Funds (ETF), which administers state employee health care benefits, the annual 10% increase assumption appears to be reasonable.

13. Based on prior compensation plans, the proposed compensation plans for 2007-09 are likely to increase the required monthly employee health insurance premium contribution rates. In the past, the employee contribution rate in the first year of the new biennium has been maintained at the same level as the second year of the preceding biennium. The table below shows the required employee contribution rates for single and family coverage in each of the three health insurance tiers in which state employee health care plans are classified. These are actual amounts for 2006 and 2007. If past practice holds, the 2008 contribution rates, as shown in the table, will remain unchanged from 2007. The calendar year 2009 contribution rates will not be known until the compensation plans are approved by JCOER.

## Monthly Employee Health Insurance Contribution Rates

<u>Plan Classification</u>	<u>CY 2006</u>		<u>CY 2007</u>		<u>CY 2008</u>	
	<u>Single</u>	<u>Family</u>	<u>Single</u>	<u>Family</u>	<u>Single</u>	<u>Family</u>
Tier 1	\$22	\$55	\$27	\$68	\$27	\$68
Tier 2	50	125	60	150	60	150
Tier 3	100	250	143	358	143	358

14. In addition to health insurance (which can be estimated at \$35.9 million in 2007-08 and \$69.0 million in 2008-09), the amounts in compensation reserves must address 2007-09 ATB pay increases, market adjustments, adjustments for classification surveys for certain employee classifications, or other salary or fringe benefit needs. It is not possible, at this time, to anticipate what ATB wage increases will be proposed in the compensation plans, or what amounts might be projected to be available for market or other adjustments for certain classifications, since a 2007-09 compensation plan has yet to be submitted. However, based on the projected health insurance reserves, the remaining GPR compensation reserve amounts for other wage adjustments would total approximately \$31.9 million in 2007-08 and approximately \$103.5 million in 2008-09.

15. Through the collective bargaining process, it could be agreed upon by the parties to allocate these funds in a variety of ways, including for such items as additional ATB increases, selected market adjustments for certain classifications, the implementation of wage survey adjustments, or to address other compensation or fringe benefit purposes.

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