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Joint Committee on Finance

Paper #215

Compensation Reserves Overview and Fringe Benefit Costs (Budget Management and Compensation Reserves)

[LFB 2023-25 Budget Summary: Page 84, #1]

CURRENT LAW

Funding is allocated to compensation reserves for cost increases related to state and University of Wisconsin (UW) System employee salaries and fringe benefits. Such costs typically include: (a) proposed pay increases, which would be finalized in the forthcoming compensation plan; and (b) inflationary cost increases for fringe benefits.

DISCUSSION POINTS

1. Under Assembly Bill 43/Senate Bill 70, funding is provided in the 2023-25 general fund condition statement for compensation reserves totaling \$365,260,700 GPR in 2023-24 (\$667,480,900 all funds) and \$581,614,700 GPR in 2024-25 (\$1,001,825,800 all funds) for cost increases related to state and UW System employee salaries and fringe benefits. Compensation reserve amounts by fund source and fiscal year are shown in Table 1.

TABLE 1

Compensation Reserves by Fund Source, 2023 AB 43/SB 70

<u>Fund Source</u>	<u>2023-24</u>	<u>2024-25</u>
General Purpose Revenue	\$365,260,700	\$581,614,700
Federal Revenue	80,773,600	112,308,700
Program Revenue	141,762,100	197,108,000
Segregated Revenue	<u>79,684,500</u>	<u>110,794,400</u>
Total	\$667,480,900	\$1,001,825,800

2. Under the bill, funding in compensation reserves was calculated as the sum of estimated cost increases for fringe benefits and estimated costs of proposed pay provisions, less a reduction of 5% of the total estimated costs. The Administration indicates the reason for the reduction is that, while estimated costs in compensation reserves for proposed pay increases are generally calculated based on filled positions only, agencies must demonstrate need for funding when requesting pay plan supplements. To the extent that agencies have vacant positions, available funding associated with the vacant positions must be utilized before a supplement would be provided from compensation reserves. The 5% reduction was applied to reflect a higher than usual level of position vacancies that may continue for some time.

3. On April 27, 2023, the Administration submitted errata materials identifying the following: (a) bill funding in 2024-25 is \$114,434,900 GPR higher than would be necessary to support proposed general wage adjustments; and (b) additional funding of \$1,052,100 GPR in 2023-24 and \$1,013,100 GPR in 2024-25 would be needed for the proposed changes to the maximum-security add-on for correctional security positions and supervisors.

4. On May 2, 2023, in executive session, the Committee removed various provisions from further consideration, including proposals to: decrease the health insurance waiting period for new employees; add June 19 and November 11 as paid holidays for state and UW System executive branch employees; provide paid family and medical leave for state and UW System executive branch employees; provide sick leave for limited-term employees of non-UW executive branch agencies and temporary employees of the UW System; and modify the vacation allowance structure for non-UW executive branch employees.

5. Also on May 2, the Committee adopted Motion #12, which included funding for standard budget adjustments (as modified under the motion), 27th biweekly payroll, sum sufficient appropriation estimates, and debt service on appropriation obligation bonds. Under the motion, the calculation for turnover reduction was modified to increase the turnover rate from 3% to 5% for all appropriations subject to a 3% turnover rate under the bill, which had the effect of reducing funding for state agency position salaries by \$8,634,200 GPR annually. Similar action was taken in 2021-23 biennial budget deliberations, increasing the rate from 3% to 4%.

The remaining items for the Committee to consider, including the errata and a recalculated 5% compensation reserve reduction, are shown in Table 2.

TABLE 2**GPR Compensation Reserves for State and UW System Employees,
Excluding Items Removed from Consideration, as Modified by Errata**

	<u>2023-24</u>	<u>2024-25</u>
Fringe Benefits-Related		
Prior Period and Inflationary Increases for State Employee Fringe Benefits	\$45,809,700	\$85,931,300
Salary-Related		
General Wage Adjustments (reestimated)	\$114,434,800	\$186,835,000
Continuation of Correctional Security Add-ons	63,258,300	60,915,100
Correctional Security Pay Progression, Minimum Pay Increase, and Supervisor Parity	85,119,800	82,408,200
Market Wage and Parity Adjustments	20,240,000	19,490,400
Medium-Security Add-on of \$1 and Maximum- Security Add-on Increase to \$4 (reestimated)	19,353,100	18,643,300
Probation and Parole Agent Pay Progression	9,244,800	9,636,400
General Pay Progression Structure	1,121,300	3,218,200
Information Technology Market Adjustments	0	2,129,700
Market Adjustments for Classified Attorneys	916,200	1,131,000
Natural Resources Warden and Capitol Police Pay Progression	<u>134,500</u>	<u>134,500</u>
Subtotal Salary-Related	\$313,822,800	\$384,541,800
Total Fringe Benefits and Salaries	\$359,632,500	\$470,473,100
5% Reduction (reestimated)	- \$17,981,600	- \$23,523,700
Net Total	\$341,650,900	\$446,949,400

6. This paper provides an overview of compensation reserves and addresses funding for prior period and inflationary increases for state employee fringe benefits, identified in Table 2. Separate budget papers have been prepared for the following provisions: (a) general wage adjustments; (b) correctional security position compensation; (c) pay progression systems; and (d) market wage adjustments, including adjustments for IT positions and classified attorneys. In addition, a budget paper has been prepared relating to the continuation of pilot add-ons in DOA, Corrections, Health Services, Military Affairs, Safety and Professional Services, and Veterans Affairs.

Overview of Compensation Reserves

7. Generally, compensation reserves represents monies set aside in the budget to provide funding for any increases in state employee salary and fringe benefit costs that may be required in the biennium, but for which funding is not included in individual agency budgets as a part of the biennial budget. The reserve funds are not allocated at the time of budget development to individual agencies because neither the amount of any salary or fringe benefit cost increases, nor the specific amount of funding needed by each individual agency, is known at the time of budget development.

8. In the 2023-25 biennium, to the extent necessary, costs of unbudgeted pay and fringe benefit adjustments would be funded from compensation reserves under the pay plan supplementation process. Under the pay plan supplementation process, the Department of Administration (DOA) requires state agencies, towards the end of each fiscal year, to document the need for any supplementation of existing budgets for the cost of any authorized pay increases (including associated fringe benefit costs, such as social security and retirement contribution payments) and for the cost of the employer's share of any increased fringe benefit costs such as 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-working day passive review process.

9. The schedule of compensation reserves (shown in Table 1) indicates reserve funding in AB 43/SB 70 for each funding source from which state employees' salaries and benefits may be funded. The respective designations of GPR, FED, PR, and SEG funding amounts are included to provide an indication of the all-funds impact of anticipated cost increases to agencies under the Administration's plans for compensation. However, the actual fiscal impact of "releasing" funds from these indicated reserves is different between GPR funds and any non-GPR funding sources. The reason for this is that the GPR funding comes from a single central source, the general fund, which consists primarily of general tax revenues. In contrast, other funding sources are not 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 revenue), the revenues are 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 to that account or fund and the expenditures of those revenues may be made only for the purposes authorized for that account or fund.

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

11. The review of compensation reserves, therefore, usually focuses on GPR funding amounts. Given these factors, this paper and other budget papers addressing amounts budgeted to compensation reserves will focus primarily on projections for the GPR share of compensation reserves.

Fringe Benefits

12. As shown in Table 2, the GPR and all funds compensation reserve amounts under the bill related to state and UW System employee fringe benefits in particular include \$45,809,700 GPR

(\$70,926,600 all funds) in 2023-24 and \$85,931,300 GPR (\$133,475,800 all funds) in 2024-25 to support prior period and inflationary increases for fringe benefits.

13. Amounts budgeted for prior period and inflationary increases include the employer share of premium costs in the forthcoming fiscal biennium for state employee health insurance, the employer share of contributions to the state retirement fund for employees' future state retirement benefits, pension obligation bond payments for the state's unfunded prior service liability for retirement benefits, and the accumulated sick leave conversion credit program.

14. This office has reviewed the calculations utilized to estimate the funding amounts associated with the fringe benefit items remaining after the Committee's May 2, 2023, actions and determined that the calculations appear reasonable. Therefore, the Committee could provide \$45,809,700 GPR (\$70,926,600 all funds) in 2023-24 and \$85,931,300 GPR (\$133,475,800 all funds) in 2024-25 to compensation reserves to fund increases in fringe benefit costs for the 2023-25 biennium. [Alternative 1]

15. As indicated above, the actual amount of supplemental funding released to an agency from compensation reserves during the pay plan supplement process is dependent, in part, on the amount of unexpended funding remaining in an agency's appropriation at the end of a fiscal year. In recent years, the overall rate of vacancies has contributed to some agencies having unexpended funds to at least partially offset any salary and fringe benefit cost increases at the end of a fiscal year. Correspondingly, compensation reserves funding has recently not been fully utilized. In 2020-21, the amount of GPR funding that lapsed from compensation reserves was approximately 7% of the amount budgeted. In acknowledgement of the dynamic between compensation reserves funding, higher agency vacancy rates, and the resulting available agency funding, the Administration applied a 5% reduction to its compensation reserves estimates. While the percentage amount of the reduction is less than what has been experienced recently with regard to lapsed funding: (a) fringe benefit costs are uncertain and could exceed the amounts estimated; (b) based on Committee actions to date, the turnover reduction calculation will be 5% rather than 3% (under budget instructions issued by DOA) or 4% (under 2021 Act 58); and (c) to the extent that compensation initiatives succeed at improving recruitment and retention of state employees, vacancy rates may decrease. Applying a 5% compensation reserve reduction would reduce funding for fringe benefit costs by \$2,290,500 GPR in 2023-24 and \$4,296,600 GPR in 2024-25, for net funding of \$43,519,200 GPR in 2023-24 and \$81,634,700 GPR in 2024-25. [Alternative 2]

16. The vacancy rate for GPR positions at non-UW executive branch agencies that had been vacant six months or more was: 4.5%, as of May 1, 2021; and 10.4% as of May 1, 2023. In 2020-21, the amount of GPR funding that lapsed from compensation reserves was approximately 7% of the amount budgeted. Given that the vacancy rate for GPR positions vacant at least six months has more than doubled since May 1, 2021, the Committee could reduce the amount of funding provided for fringe benefit cost increases by 5%, as was done under AB 43/SB 70. [Alternative 2]

17. If the Committee takes no action regarding current law fringe benefit cost increases and decreases budgeted to compensation reserves, agencies would need to manage any fringe benefit cost increases within appropriated budgets. [Alternative 3]

ALTERNATIVES

1. Provide \$45,809,700 GPR (\$70,926,600 all funds) in 2023-24 and \$85,931,300 GPR (\$133,475,800 all funds) in 2024-25 to compensation reserves to fund increases in fringe benefit costs for the 2023-25 biennium.

ALT 1	Change to Base
GPR	\$131,741,000

2. Provide funding to compensation reserves for increases in fringe benefit costs as estimated, less 5% (\$2,290,500 GPR in 2023-24 and \$4,296,600 GPR in 2024-25), for net funding of \$43,519,200 GPR in 2023-24 and \$81,634,700 GPR in 2024-25.

ALT 2	Change to Base
GPR	\$125,153,900

3. Take no action.

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