Legislative Fiscal Bureau
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

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Compensation Reserves Overview
(Budget Management and Compensation Reserves)

[LFB 2011-13 Budget Summary: Page 74, #1]

CURRENT LAW

For the 2009-11 biennium, all funds compensation reserves totaled $116,131,700 in 2009-10 ($47,279,100 GPR and $68,852,600 Other Funds) and $235,010,000 in 2010-11 ($95,962,700 GPR and $139,047,300 Other Funds).

GOVERNOR

Provide, in the 2011-13 general fund condition statement, all-funds compensation reserves of $56,388,100 in 2011-12 and $159,881,000 in 2012-13 for the increased cost of state employee salaries and fringe benefits. Total compensation reserve amounts by fund source and fiscal year are shown in Table 1.

TABLE 1

AB 40 Compensation Reserves

Fund Source	2011-12	2012-13
General Purpose Revenue	$26,790,000	$77,910,000
Federal Revenue	16,662,700	45,710,000
Program Revenue	5,932,000	16,643,600
Segregated Revenue	7,003,400	19,617,400
Total	$56,388,100	$159,881,000

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 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 agency budgets because neither the amount of any salary or fringe benefit costs increases, nor the specific amount of funding needed by each individual agency, is known at the time of budget development.

2. More specifically, the funding levels provided within compensation reserves are intended to cover: (a) the increased employer salary and associated fringe benefit costs resulting from any compensation plan increases for non-represented employees and UW System 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); (b) the costs of salary and associated fringe benefit costs that may be provided to represented state employees under collective bargaining agreements covering the state's 19 established bargaining units that are approved for the 2011-13 biennium; (c) increases in premium levels for state employee health insurance, which are determined in the fall of each year to become effective the following January; and (d) increases in the employer share of contributions to the Wisconsin Retirement System (WRS) for employees' future retirement benefits.

3. In the 2011-13 biennium, to the extent necessary, these categories of costs will be funded from the compensation reserves under the pay plan supplementation process. The pay plan supplementation 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 (shown in Table 1) indicates reserve funding for each funding source 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 costs of the pay plan supplements; what they require is the authorization to increase their total spending authority by the amount of the requested supplement.

6. The review of compensation reserves, therefore, usually focuses on GPR funding levels. As indicated in Table 1, GPR compensation reserves under the bill total $104,700,000 ($26,790,000 in 2011-12 and $77,910,000 in 2012-13). 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 health insurance premium costs increase by 10% in each year, the cost increase is applicable to all employees, whether an individual 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. The DOA 2011-13 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.

9. However, several recent developments impact the calculation of compensation reserves for health insurance coverage in the 2011-13 biennium. First, under 2011 Act 13, $28.0 million will be reallocated from group health insurance and pharmacy benefit reserves in ETF to reduce employer costs for providing group health insurance for state employees in the first six months of 2011-12 (July through December, 2011). Second, a 5% cost reduction for health insurance coverage in 2012, is mandated under 2011 Act 10. [Note that, as of this writing, a temporary restraining order has been issued, halting implementation of Act 10 provisions.]

10. Third, the employer share of health insurance costs will be reduced because employee contributions were increased under Act 10. Under Act 10, employee monthly contributions for health insurance coverage in 2011 will increase on the effective date of the Act to

$84 for single coverage and $208 for family coverage under tier 1 plans; $122 for single coverage and $307 for family coverage under tier 2 plans; and $226 for single coverage and $567 for family coverage under the tier 3 plan. Employee-required contributions for health insurance coverage in the future would be established by the OSER Director. Assuming 10% annual increases in premium costs for state employee health insurance coverage, proportional increases in employee contributions for health insurance coverage, and factoring in the additional reductions to state costs discussed above, it appears that the compensation reserves proposed under the bill would be adequate to cover the increased health insurance costs of the state.

11. Due to the health insurance cost-reduction factors discussed above, it would be expected that compensation reserves in 2011-13 would be established at levels lower than those in the prior biennium. This is the case, as shown in Table 2. Note that reserves in the second year of a biennium are always higher than the first year because two years of higher, unbudgeted costs must be covered in the second year.

TABLE 2

General Fund Compensation Reserves
2009-11 and 2011-13

	2009-10	2010-11
2009 Act 28	$47,279,100	$95,962,700
	2011-12	2012-13
2011 AB 40	$26,790,000	$77,910,000
	1st Year	2nd Year
Difference	-$20,489,100	-$18,052,700
Percent Change	-43%	-19%

12. In addition to health insurance cost increases, the amounts in the compensation reserves must address, if provided, any 2011-13 across-the-board pay increases, market adjustments, adjustments for classification surveys for certain employee classifications, or other salary or fringe benefit needs. Given current economic conditions, any compensation adjustment may be relatively modest.

13. The administration has not yet submitted to JCOER its recommendations for the 2011-13 compensation plans for non-represented employees and for UW System faculty and academic staff. Therefore, it is not known at this time what recommendations will be included in those plans, effective for fiscal years 2011-12 and 2012-13. These compensation plans provide an important context for estimated future employer costs for state employee compensation, including fringe benefits.

14. Arguably, for two reasons, there may be unbudgeted wage increases in the 2011-13 biennium that would potentially draw amounts from the reserves. First, Act 10 prohibits any

municipal employer under the Municipal Employment Relations Act (MERA) or the state under the State Employment Labor Relations Act (SELRA) from bargaining collectively with a collective bargaining unit containing general employees with respect to any factor or condition of employment except base wages. Unless approved by referendum, any increase in base wages that exceeds the total base wages for authorized positions 180 days before the expiration of the previous collective bargaining agreement by a greater percentage than the increase in the consumer price index (CPI) would be prohibited. [Certain "public safety employees" under Act 10 would maintain full pre-Act 10 collective bargaining rights.]

Under Act 10, therefore, the state must bargain over base wages with represented employees. The CPI increases currently projected for 2012 and 2013 are 1.9% and 2.0% respectively. Although these potential CPI increases may not result in base wage increases of these magnitudes, it is possible that the state could agree to some level of general wage adjustments for represented employees (both general and public safety employees) though the collective bargaining process and for nonrepresented employees through the state's compensation plans in the 2011-13 biennium. To the extent necessary, such general wage adjustments could be funded through the compensation reserves.

15. Second, on April 26, 2011, the Committee adopted Motion #57 under budget deliberations for the Office of State Employment Relations. The motion specified that, in the 2011-13 biennium, state agencies be allowed to retain base funding for certain state attorneys who retire during this period and to utilize the difference between the salaries of the retiring attorneys and the salaries of new attorneys to be utilized for the institution of a pay progression system under a plan approved by the Joint Committee on Finance. The provision would be limited to state agency attorneys (that is, members of the Wisconsin State Attorneys Association [WSAA]). The motion requires the WSAA and OSER to develop a plan for the establishment of a pay progression system for these attorneys to be submitted to the Joint Committee on Finance on or before September 30, 2011. The plan must include a detailed description of how the pay progression system would be structured and administered and the fiscal cost of the system in the 2011-13 biennium, by fund source, and the projected costs in the following four biennia. The motion requires that the plan be approved by the Joint Committee on Finance under a 14-day passive review process.

While the fiscal implications of this provision will not be known until the WSAA/OSER report is submitted for review, the cost of a pay progression system can be significant. If pay progression is eventually approved for some or all state attorneys, any unbudgeted costs increases beyond retained salary savings could be funded through the compensation reserves.

16. Reserve increases may also be expected to reflect anticipated higher employer contributions for WRS benefits in 2012 and 2013, primarily associated with the five year allocation of investment losses from 2008. Under Act 10, the authority for WRS participating employers (both the state and local employers), to pay all or part of the retirement contributions required of participating employees was repealed except for represented local police, local firefighters, state troopers, and state inspectors. Act 10 also generally requires that the WRS contribution rate be divided equally between the employer and the employee. While these provisions result in transference of significant expenses to state employees, the state may still have unbudgeted retirement costs in 2011-13 that could potentially be addressed through the compensation reserves.

17. As noted above, the supplementation process is based on actual, documented need for each state agency at the end of a fiscal year. Draws from the compensation reserves are only in the amounts necessary to provide funds for unbudgeted salary and fringe benefit costs. Salary or fringe benefit supplementation requirements exceeding the compensation reserve amounts would need to be absorbed by each state agency. Therefore, it important that the level of GPR compensation reserves be established accurately. It appears that the GPR compensation reserves under the bill would be adequate to address health insurance cost increases in the 2011-13 biennium and potential increases in WRS contributions in 2012 and 2013. Depending on the level of actual cost increases for fringe benefits that are incurred, some level of compensation reserves may also be available for wage adjustments, although the extent of available reserves cannot be projected at this time.

Prepared by: Art Zimmerman