

BUDGET LETTER

SUBJECT: 2003-04 PERSONAL SERVICES REDUCTION PLANS	NUMBER: 03-21
REFERENCES: EXECUTIVE ORDER D-71-03, BUDGET LETTERS 02-27, 03-17, AND 03-19	DATE ISSUED: July 22, 2003
	SUPERSEDES: BUDGET LETTER 03-06

TO: Agency Secretaries
Department Directors
Departmental Budget Officers
Departmental Accounting Officers
Department of Finance Budget Staff

FROM: DEPARTMENT OF FINANCE

Budget Officers are requested to forward a copy of this Budget Letter (BL) to Departmental Human Resources and Labor Relations Officers.

This BL updates and clarifies information provided in previous BLs on the 10 percent reduction plans. It also provides worksheets that departments must complete that will allow the Department of Finance (Finance) to implement Control Section 4.10 for the employee compensation reductions anticipated in the upcoming 2003 Budget Act. Note that the worksheets are due to Finance no later than July 31, 2003. (For a description of the pending version of Control Section 4.10, see BL 03-19.)

To safeguard against state operations deficiencies in 2003-04, the Administration has directed departments to update their reduction plans and Finance to review and approve them (BL 03-19). The intent is for departments to implement the plans as quickly as possible, even potentially in advance of the results of collective bargaining and enactment of the budget.

Rapid implementation of reduction plans is unavoidable, because delay heightens the effect of a budget shortfall, resulting in the need to cut more deeply into operations than would otherwise be needed. Of necessity, Finance has made assumptions about what employee compensation and position reductions will be included in Control Section 4.10 of the final budget. *These assumptions may change and in any event will be superseded by the final requirements in the Budget Act. As requirements change, departments may need to update their reduction plans (and potentially their layoff plans). Therefore, departments are advised to keep in close contact with their Finance Budget Analysts and their Department of Personnel Administration Analysts and to read BLs carefully and promptly.*

Meanwhile, until current reduction plans are reviewed and approved, departments that do not already have employees on surplus status are required to issue surplus notices to those employees with 30 months or less of total State service. Once reduction plans are reviewed and approved, appropriate changes can be made to the surplus list. Questions on the surplus and layoff process should be directed to the Department of Personnel Administration.

Please note that the reduction plans will be implemented at or near their full value. Therefore, department directors are once again encouraged to select their reductions carefully, considering program impacts and the effects on revenues, matching funds such as federal funds or reimbursements, or any other funding arrangements that depend on expenditures that will be reduced as part of the proposed ten percent reduction plan. Department directors should be prepared to address and defend why they selected the particular positions and the expected programmatic impact of the reductions.

Relationship of Employee Compensation Reduction, the 10 Percent Reduction Plans, and the Abolishment of Vacant Positions

If collective bargaining results in the employee compensation savings required in the final Budget Act (currently \$855 million), then the 10 percent reduction plans will not be needed during 2003-04 as the alternative strategy to achieve staffing savings. In that event, departments will be able to restore positions scheduled for layoff, and the position reduction target in Control Section 4.10 (currently 13,000) will be eliminated.

If the 10 percent reduction plans are not needed, then the vacant positions abolished by Executive Order D-71-03 can also be restored, although they would continue to be subject to the hiring freeze and an exemption would have to be approved before a position could be filled. These positions were abolished to “jump start” savings towards the \$855 million. This was necessary because bargaining is still underway so potential savings from bargaining is delayed, and the layoffs included in the reduction plans will also take several months to implement.

If collective bargaining results in *less* savings than required by the Budget Act, then some or all of the 10 percent reduction plans will be a permanent reduction in funding. In addition, some or all of the required position reductions in Control Section 4.10 will also become permanent.

There has been some confusion about the potential cumulative effect of the 10 percent reductions and the elimination of positions that were vacant as of June 30, 2003. The vacant positions that were abolished by Executive Order D-71-03 are *not* in addition to the 10 percent reduction plans. Instead, they stand temporarily in lieu of a portion of the savings that the plans must deliver. (The exception to this statement is if a department has chosen to incorporate some of its abolished positions into its reduction plan.) Once permanent reduction plans are approved and layoff notices are issued, departments may submit requests to reestablish abolished positions, as described in BL 03-19. These requests will be subject to approval by the Finance Program Budget Manager and under no circumstances will they be approved unless the Department of Finance agrees that reestablishment of these positions will not result in a deficit in the department.

All Departments, Regardless of Fund Source or Whether Appropriated in the Budget, Must Reduce Personal Services Costs

Departments with special fund sources, nongovernmental funds, federal funds, reimbursements, or off-budget appropriations must prepare reduction plans for each of these fund sources. There are several reasons for this requirement. First, since the goal is to achieve statewide employee compensation savings, it would be inequitable to exempt some fund sources—and therefore some employees. Also, the statewide position reduction target applies to all funds. To exempt some programs because of their fund source creates a burden for the remaining programs. In addition, some special funds are also experiencing imbalances between revenues and expenditures. (Departments are reminded to update their layoff plan as necessary, regardless of fund source.)

The only entities excluded from reduction planning are the Legislature, Legislative Counsel Bureau, Bureau of State Audits, Judicial, University of California, Hastings College of Law, and the California State University.

Reduction Plans Must Be Proportionate By Fund

The April 1, 2003, joint letter from the Directors of Finance and Personnel Administration advised departments that their reduction plan must have a “fund split between General Fund and other funds...[that mirrors] state operations funding for the department.” Finance is now clarifying that

information: the department's plan must include a 10 percent reduction for *each fund's share of personal services*.

This clarification is necessary because some departments lumped their non-General Fund staffing costs together and proposed reduction plans that were disproportionate by fund. This will not work, because each fund must cover its own share of employee compensation costs.

Updated Instructions for Departments with "Exclusive" Funds.

BL 03-19 stated that departments with exclusive funds (i.e., a fund appropriated only to that department) would be held to a lower reduction target than 10 percent. However, Finance has now determined that it may not be possible to achieve position savings of 13,000 or greater if some departments/funds have a reduced target. Therefore, Finance's original instruction that all departments must prepare 10 percent reduction plans has been reinstated. *To the extent possible, exclusive funds sources will be given special consideration at the time final reduction decisions are made.*

Base for 10 Percent Plans; No Overlap with Reductions in the Budget

The final reduction plans must be based on the enacted budget as revised by vetoes. Initial targets may need to be adjusted once the budget is signed. Departments should consult with their Finance Budget Analysts at that time to determine if any further revisions will be required.

Please note that the \$855 million savings target for employee compensation is in addition to all other budget reductions enacted by the Legislature. Therefore, *departments should not include in their reduction plans any proposals that are likely to be separately included in the final Budget.* If there is an overlap, departments must adjust their plans.

Reductions Requiring Statutory Change Cannot Be Included as Part of 2003-04 Reduction Plans

Some departments have asked if they may submit proposed reductions that would require enabling legislation. Unfortunately, there is no guarantee that such legislation could be enacted during 2003-04. Therefore, departments' reduction plans must be based on current law or practice. However, departments are encouraged to prepare such proposals for 2004-05 as part of the anticipated reductions for that fiscal year.

Use of Operating Expenses and Equipment Funds

Many departments have asked if they can use operating expenses and equipment (OE&E) reductions in lieu of staffing reductions. This is not practical given the anticipated requirement to eliminate 13,000 positions in 2003-04. However, departments may use OE&E funds to meet one-time implementation costs of the reduction plan. Such costs could result from delays in layoff, lump-sum buyouts, and other costs associated with transitioning the workforce to a lower level.

Reduction Plans Must Be Increased to Address Other Potential State Operations Shortfalls

Some departments may be aware of other potential shortfalls in state operations funding, such as unmanageably high salary savings or operating expense increases. Finance does not anticipate forwarding *any* state operations deficiency requests to the Legislature except for extraordinary, unplanned situations that are clearly beyond a department director's ability to control.

Therefore, a department should address its other potential funding shortfalls now by increasing its reduction target beyond 10 percent and making further cuts of personal services or operating expense.

Department directors are reminded that they are personally responsible for keeping the department's budget in balance, as explained in BL 02-27.

2003-04 Retirement Contributions

Departments will be receiving supplemental funding for the 2003-04 increase in retirement contributions. Allocations will be made by an Executive Order this fall. Therefore, departments will not be required to redirect resources to cover the retirement contribution increase.

There is currently a plan to fund 2003-04 retirement costs using pension obligation bonds. There will be no impact to departments' budgets since this transaction will be made at the statewide level and will not affect individual departments.

Employee Compensation Reduction Worksheets

This section contains the instructions and forms for (1) departments to calculate their increased personal services costs that will result if concessions are not negotiated, (2) departments to revise their reduction plans, (3) departments to provide scheduling information for a base reduction and potential redistribution of funds, and (4) departments to prepare a one-time shortfall plan.

Departments are reminded that the revised 10 percent reduction plans are due to Finance by July 31, 2003, however, earlier submittals are encouraged for those reduction plans requiring less extensive revisions. Accordingly, *the Attachments provided in this BL are also due no later than July 31, 2003*, to assist Finance in assessing the reduction plans.

Attachment I—Personal Services Annualized Plan Cost Calculations (Use a Separate Form for Each Fund)

Attachment I requires departments to calculate (1) the cost of employee compensation increases that will occur if the unions do not agree to concessions, (2) the department's share of the base reduction, (3) the amount of funding that is needed for the department to maintain one percent of personal services as a contingency for uncertainties, and (4) the amount that would be available for redistribution.

Departments must complete a separate form for each fund and provide the amount of budgeted personal services attributed to the fund. Enter only whole dollars and positive numbers in every cell.

Cell A: Provide the fund's appropriate share of the department's 2003-04 personal services budget as reflected in the 2003-04 Governor's Budget, adjusted by April and May Finance Letters. If the Legislature has made significant changes to the May Revision, consult with your Finance Budget Analyst on the appropriate number to provide.

Cell B: The spreadsheet will calculate this cell automatically.

Cell C: Provide the salary savings rate reflected in the 2003-04 Governor's Budget.

Column D: Provide the best estimate of the 2003-04 authorized positions by bargaining unit as reflected in the 2003-04 Governor's Budget, adjusted by April and May Finance Letters. If the Legislature has made significant changes to the May Revision, a department should consult with its Finance Budget Analyst on the appropriate estimate for positions.

Column E: Provide the annual salary base reflected in the 2003-04 Governor's Budget as adjusted by April and May Finance Letters. If the Legislature has made significant changes to the May Revision, consult with your Finance Budget Analyst on the appropriate salary base to provide.

Column F: Enter the total annual GSI for the Unit Salary Base (based on a 5 percent salary increase for Units 1-4 and 7-21; for units 5 & 6, consult with your Finance Budget Analyst for the appropriate percentage to use).

Column G: The spreadsheet will calculate this cell automatically.

Column H: The spreadsheet will calculate this cell automatically.

Column I: Use the following percentages of Annual Amount of GSI: 22.5 percent for Miscellaneous Tier 1, 17.9 percent for Miscellaneous Tier 2, 18.7 percent for State Industrial, 29.6 percent for State Safety, 40.3 percent for State Patrol, and 28.0 percent for State Peace Officer/Firefighter.

Column J: Include costs that will increase because of the GSI, such as overtime and recruitment and retention differentials.

One Percent Contingency: The spreadsheet will calculate one percent of the personal services total that departments may need to maintain as a contingency for uncertainties. Departments may be allowed to keep the amount of savings generated from implementing the reduction plan as is necessary to fund this contingency. Otherwise, the amount reserved for contingency will be added to the amount available for redistribution.

Base Reduction: Attachment IV contains a list of base reductions attributed to each department. Departments must allocate this base reduction to each fund based upon the fund's share of the personal services budget. An executive order will be issued in the fall to reduce departmental budgets by this amount.

Total Ongoing Budget Shortfall: The spreadsheet will calculate the sum of the increased employee compensation, the one percent contingency, and the base reduction.

Credit For Excluded Employees: Provide the amount of savings for the fund that will be generated by not providing excluded employees a GSI. In most cases the amount of the savings will be five percent of the employee's salary plus savings associated with salary driven benefits.

Amount Available for Redistribution: The spreadsheet will calculate the difference between the 10 percent target and the sum of the Total Ongoing Employee Compensation Shortfall plus the Initial Credit For Excluded Employees. This amount will be available for redistribution to other departments. The amount calculated for a one percent contingency for uncertainties may be added to this total for redistribution.

Attachment II—Personal Services Annualized Plan Reductions

The reduction plan form contained in BL 03-06 has been revised to provide detailed information for each fund. *All departments must submit a revised reduction plan in this new format.*

Associated layoff plans must include all positions identified in the revised reduction plan for elimination that are not currently vacant. The department must inform the Department of Personnel Administration of any changes in reduction plans that will require a revision of the department's layoff plan, as soon as they are known. The reduction plans cannot include operating expenses and equipment costs or local assistance costs, except to address budget problems beyond the 10 percent reduction plans. All position reductions will be permanent.

Salary Savings Rate: Provide the salary savings rate reflected in the 2003-04 Governor's Budget.

Fund Number/Name: Provide the name and number for each of the department's funds. Add additional columns as needed.

Personal Services By Fund: Provide each fund's appropriate share of the department's 2003-04 personal services budget as reflected in the 2003-04 Governor's Budget, adjusted by April and May Finance Letters. If the Legislature has made significant changes to the May Revision, consult with your Finance Budget Analyst on the appropriate number to provide. The spreadsheet will calculate the 10 percent reduction plan target.

Credit For Excluded Employees: Provide the amount of savings for each fund that will be generated by not providing excluded employees a GSI. In most cases the amount of the savings will be five percent of the employee's salary plus savings associated with salary driven benefits.

Net Fund Target: The reduction plan must equal the Net Fund Target for each individual fund source.

Position Reductions: Separate the position reductions by individual reporting units (add additional rows if needed). Since position numbers will have to be provided at a later time, include the position classification and other requested information for each position that is being proposed for elimination. The reduction plans cannot contain any position that is likely to be eliminated by the budget (check with your Finance Budget Analyst if you are unclear which positions are likely to be eliminated).

- Include positions that do not require legislative or regulatory changes or substantially impact sensitive programs. In addition, a priority should be placed on eliminating positions that would produce immediate savings, such as vacant positions, temporary employees, and student assistants.
- Amount of Gross Annual Salary should be based on positions being eliminated effective July 1, 2003 and costed at mid-step plus any differentials. To reduce the number of positions that departments will have to eliminate, the cost of positions should include the GSIs that were scheduled to take effect on July 1, 2003 (5 percent salary increase for Units 1-4 and 7-21; for units 5 & 6, check with your Finance Budget Analyst for the appropriate percentage to use).
- Benefits should be based upon the following percentages of gross salary: 31 percent for Miscellaneous Tier 1, 26.4 percent for Miscellaneous Tier 2, 27.2 percent for State Industrial, 38 percent for State Safety, 48.8 percent for State Patrol, and 36.4 percent for State Peace Officer/Firefighter.
- Descriptions of program impacts should address, for example, effects on service levels, federal funds, reimbursements, and matching funds.

Non-Position Reductions: Include any reductions to temporary help or overtime in this section.

Attachment III—Personal Services Annualized Plan Scheduling Worksheet

Provide scheduling information for the base reduction and the amount available for redistribution calculated on Attachment I. An executive order will be issued in the fall to reduce appropriations for the base reduction. An additional executive order may be issued in the fall to reduce appropriations for redistribution to other departments.

Attachment IV—Base Reduction Allocation

This attachment identifies the department's share of the \$95.5 million base reduction. Note: This base reduction is not tied to any previous augmentation that the department received for employee compensation. Departments must provide on Attachment I the prorated amount of the base reduction to each fund, based upon the fund's share of the personal services budget.

Attachment V—One-Time Issues

Some elements of the 10 percent reduction plans will take time to implement (e.g., the layoff process). Attachment V provides the method for departments to identify and report to Finance the one-time issues required to implement the Annualized Plan. Examples of one-time issues include the inability to achieve immediate savings associated with the layoff process, the impact on salary savings related to the elimination of the vacant positions, and the one-time and potentially significant cost of leave buy-outs. (Departments are reminded that although vacant positions have been eliminated effective June 30, 2003, the associated dollars currently remain in department budgets.) When determining salary savings flexibility associated with the abolishment of vacant positions, departments should also determine and reflect budgeted salary savings in their calculations. Also, solutions available to fund these one-time shortfalls can originate from the operating expenses and equipment category; however, local assistance appropriations are restricted unless they fund employee compensation.

Departments should complete this process carefully since deficiencies related to employee compensation will not be considered. The departments' ability to operate within existing resources is tied directly to the soundness of the decisions incorporated in this process.

If you have any questions regarding this BL, please contact your Finance Budget Analyst.

/s/ KATHRYN RADTKEY-GAITHER

KATHRYN RADTKEY-GAITHER
Assistant Director

Attachments