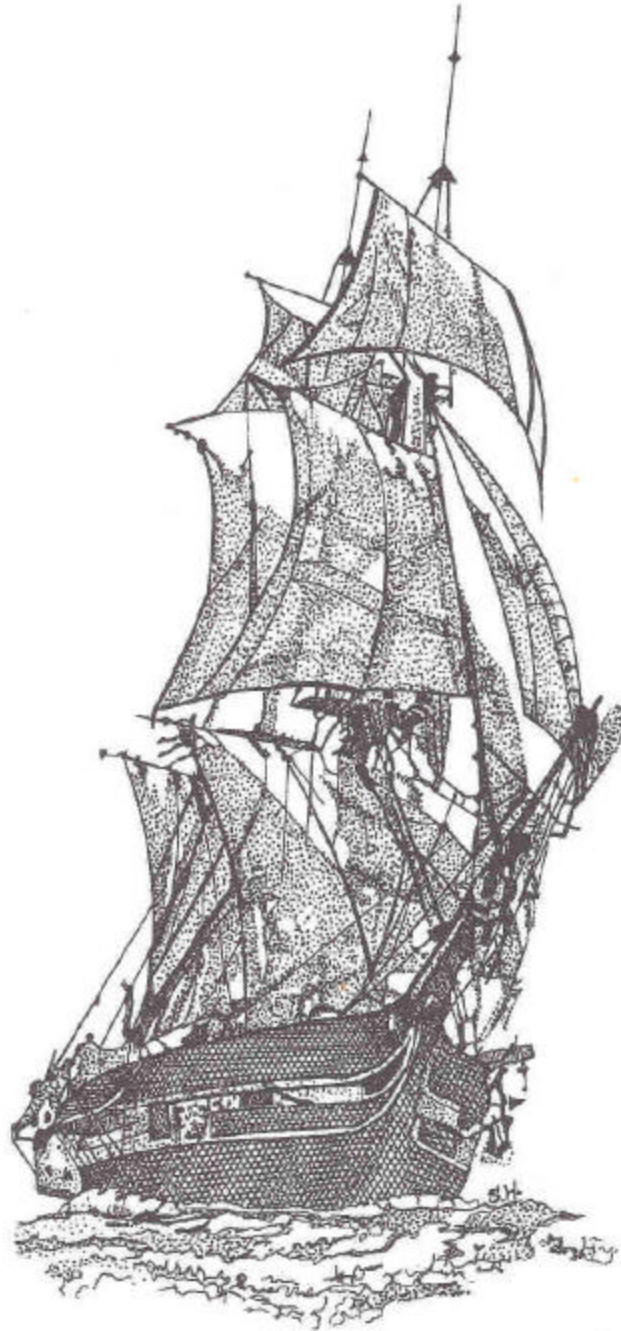


**ORANGE
COUNTY
GRAND
JURY**



The Pilgrim at Dana Point Harbor

**FINAL
REPORT
2002-2003**

**Who Represents
Orange County Taxpayers?
MAY 16, 2003**

WHO REPRESENTS ORANGE COUNTY TAXPAYERS?

SUMMARY

Salaries and employee benefits represent a significant portion of the County's expenditures. For fiscal year 2001-2002, they amounted to approximately \$1.11 billion of the County's \$2.65 billion total reported operating expenditures, nearly forty-two percent of the total. Controlling employee payroll and benefits is vital in order to manage the overall County budget. A central issue associated with managing employee expenditures in Orange County is that the agencies or departments need to have control of the many significant cost factors associated with these expenses. This control has recently been absent because these agencies or departments have been left out of the decision making process in wage and benefit issues.

Orange County has a highly unionized work force. Unionization has recently expanded to include 99% of the entire Orange County work force. Union negotiations with the County over terms and conditions of employment are handled by the CEO Human Resources Office.

While the CEO Budget Office staff initially provides CEO Human Resources Office with budget limitations for these negotiations, the CEO Budget Office staff plays no further role in costing out negotiation proposals, or in ensuring that proposals offered and agreed to by employee unions are within financial limitations. This process offers limited checks and balances and does not have an accountability structure. As a result, many recently negotiated agreements have been approved without full understanding of the true and actual financial impact.

Because the trend of expanding wage and benefits to County employees appeared to be a potential financial crisis in the making, a group of concerned high level County officials and agency heads proposed procedural changes. They recommended that a steering committee should be formed to guide the CEO Human Resources Office's future actions in these matters. Initially, this idea was rejected by the CEO Office. Since that time, CEO Office personnel has changed, and the Board of Supervisors now seems more favorably disposed toward this control measure. It appears, based on recent actions that salary and employee benefit increases have been generously distributed with little regard to impacts on County budgets or taxpayer interests. These increases include the following:

- Safety Members Retirement System
- Educational and Professional Reimbursement Program
- Performance Incentive Plan (PIP)
- Early Incentive Retirement Plan
- Annual Leave

INTRODUCTION AND PURPOSE

In recent years a continuum of increased employee benefits, incentive programs and pay raises have been bestowed on the Orange County work force by the Orange County Board of Supervisors (BOS). Because payroll and related expenses represent a major portion of the total budget, the 2002-2003 Orange County Grand Jury elected to evaluate the procedures used in making the decisions to implement these increases. This trend to increase salaries and benefits is especially significant because it has occurred during an unrelenting bear market and period of low interest rates.

Private industry has curtailed salaries and benefits to bring payroll costs into closer alignment with realities. Orange County, in contrast, has not taken the cost cutting measures of private industry. Even though County officials often state that they are modeling their behavior on private industry, they behave in a contrary manner. Orange County has greatly increased payroll and related benefits. This report explores the issues leading to these major runaway expense increases.

METHOD OF STUDY

The Grand Jury interviewed elected officials, agency and department heads, management, and staff for many Orange County governmental functions. The Grand Jury interviewed officials of the Orange County Retirement System. The Grand Jury reviewed relevant County budgets, reports, Memoranda of Understanding, Agenda Item Transmittals and Board of Supervisor's Actions.

BACKGROUND

Orange County has a highly unionized work force. In fact, unionization has recently expanded to 99% of the entire Orange County work force. The accompanying table shows the six major labor organizations representing approximately 17,000 of the County's nearly 18,000 employees. The table also provides information on the labor organizations and contract terms. Recent developments have seen the administrative managers also form a labor organization, the Orange County Management Association (OCMA), for their approximately 800 members. This was in response to the administrative managers' pay and benefits lagging behind those of the other County employees most of whom belong to labor organizations. With the administrative managers becoming members of a labor organization, all but 200 employees--such as elected officials, their staff, executive managers and law enforcement managers--of the 18,000 county employees are now represented by labor organizations.

Orange County Collective Bargaining Units¹

<p>Orange County's Attorneys Association (OCAA) – Attorney's Units</p> <p>Contract Term: July 2000 through June 2003 Number of employees: 425 Terms of Agreement:</p> <p>FY 2000 – 01 4% Wage Increase 1% PIP Incentive FY 2001 – 02 4% Wage Increase 1% PIP Incentive FY 2002 – 03 3.5% Retirement pick-up in lieu of Wage Increase 1% PIP Incentive</p>	<p>Orange County Employees Association (OCEA) – Community Services, County General, Office Services, Probation Services, Probation Supervisory and Management, Sheriffs Special Officers & Deputy Coroner, Supervisory Management Units</p> <p>Contract Term: July 2000 through June 2003 Number of employees: 13,000 Terms of Agreement:</p> <p>FY 2000 – 01 4% Wage Increase 2% PIP Incentive FY 2001 – 02 4% Wage Increase 2% PIP Incentive FY 2002 – 03 3.5% Wage Increase 2% PIP Incentive</p>	<p>International Union of Operating Engineers (IUOE) – Local 501, AFL-CIO, Craft and Plant Engineer Unit</p> <p>Contract Term: July 2000 through June 2003 Number of employees: 125 Terms of Agreement:</p> <p>FY 2000 – 01 4% Wage Increase 2% PIP Incentive FY 2001 – 02 4% Wage Increase 2% PIP Incentive FY 2002 – 03 3.5% Wage Increase 2% PIP Incentive</p>
<p>Association of Orange County Deputy Sheriffs (AOCDS) – Peace Officer/Supervising Peace Officer Unit</p> <p>Contract Term: October 1999 through October 2002 – Contract extended through 2003</p> <p>Number of employees: 1,800 Terms of Agreement:</p> <p>FY 1999 – 00 3.5% Wage Increase FY 2000 – 01 4% Wage Increase FY 2001 – 02 3.5% Retirement pick-up in lieu of Wage Increase FY 2002 – 03 4% Wage Increase</p>	<p>American Federation of State, County and Municipal Employees (AFSCME) Council 36, Local 2076 AFL-CIO – Eligibility Workers Unit</p> <p>Contract Term: July 2000 through June 2003 Number of employees: 1,100 Terms of Agreement:</p> <p>FY 2000 – 01 4% Wage Increase 2% PIP Incentive FY 2001 – 02 4% Wage Increase 2% PIP Incentive FY 2002 – 03 3.5% Wage Increase 2% PIP Incentive</p>	<p>Service Employees International Union (SEIU) – Chapter 787, AFL-CIO – Operations Service Maintenance</p> <p>Contract Term: July 2000 through June 2003 Number of employees: 485 Terms of Agreement:</p> <p>FY 2000 – 01 4% Wage Increase 2% PIP Incentive FY 2001 – 02 4% Wage Increase 2% PIP Incentive FY 2002 – 03 3.5% Wage Increase 2% PIP Incentive</p>

Salaries and employee benefits represent a significant portion of the County's expenditures. For fiscal year 2001-2002, they amounted to approximately \$1.11 billion of the County's \$2.65 billion total reported operating expenditures, nearly forty-two percent of the total. Controlling employee payroll and benefits plays a vital role in managing the overall county budget. A central issue associated with managing these employee expenditures is that the County departments do not control many of the significant cost factors associated with these expenses. For instance, one department administrator was compelled to modify the budget and drop programs explaining, *"The impact of state and local budget uncertainty, coupled with a nearly seventeen percent increase in employee benefit costs require us to take a closer look at all of our existing programs."* Operational capabilities of the agency are being diminished. It is forced to eliminate existing programs because wage and benefit increases leave no other alternative.

Union negotiations with the County over terms and conditions of employment are handled by the County Executive Office (CEO), Human Resources Office. Some of the most recent items that have been negotiated are Safety Member Retirement, Educational and Professional Reimbursement Program, Performance Incentive Program (PIP), Early Incentive Retirement Plan, and Annual Leave.

Orange County Safety Members Retirement System

Orange County's retirement system is a 1937 Act retirement system. Safety Members are generally defined as fire fighters, sworn deputies, investigators, sergeants and law enforcement management of the Orange County Sheriff's Department and the District Attorney's Bureau of Investigations.

Generally safety members can retire at age 50 and with 10 or more years of retirement service credit, or with 20 years or more of retirement service credit, regardless of age. The previous retirement formula was 2% times salary times years of service. The new benefit provided in 1999 by Assembly Bill 1937 and adopted by the BOS, effective June 28, 2002, increased the 2% to 3% in the formula and is known as the 3% at 50 formula. Safety members can retire at age 50 with 30 years of service with a retirement benefit that equals 90% of pay. Additionally the benefit was applied retroactively further increasing the benefit and increasing cost for all current employees.

The increase from 2% to 3% is a 50% increase in retirement benefit for nearly all safety employees.

At this time, 1,802 law enforcement officers and 754 fire fighters have been given the 3% at 50 retirement benefit. In 2005 an additional 1,047 Probation Department employees are due to be included in the increase to 3%. The Probation Department will not have the benefit applied retroactively. Total increased costs for these expanded benefits are estimated to be \$28.7 million annually.

The Retirement System and Investment Markets

Pension funds largely rely upon Orange County Employee Retirement System (OCERS) investments for funding. The County taxpayer will have to come up with any funds which an under performing investment market fails to provide. The last three years of steep decline in market performance portends a strong likelihood that additional taxpayer contributions will be required.

Educational and Professional Reimbursement Program

During the course of interviews and investigations the Grand Jury received many comments from agencies or departments that the Educational and Professional Reimbursement expenses had doubled and, in some cases, nearly tripled. On June 29, 2001, a new Educational and Professional Reimbursement Program became effective, that increased the maximum amount allowable to any one employee from \$750 annually to \$2,000 annually. The new program also relaxed the eligibility definitions so that managers have very little authority to enforce requirements no matter how unrelated a class, course, seminar, or professional license may be. The cost rose from \$0.3 million in 2000-2001 to \$1.6 million in the year 2001-2002. This represents more than a 500% increase in cost in just the first year of the expanded benefit! If that pattern holds to form in 2003, it will present further bad news for taxpayers in an economic period wherein the outlook for County revenues is falling while costs are significantly rising.

Performance Incentive Plan (PIP)

The Performance Incentive Plan (PIP) was implemented for the purpose of rewarding increased employee productivity. The result, however, is that most County departments are paying a 2% PIP bonus to 95-98% of all employees. Logic would dictate that this so called Performance Incentive Plan is actually a flat 2% pay raise for almost all employees. It is not a true incentive plan, but rather an across the board 2% pay raise disguised as an incentive plan. In 2000-2001 PIP cash awards totaled \$5.8 million. In 2001-2002 that figure nearly doubled to \$11.2 million. The PIP budget for 2002-2003 exceeds \$15.5 million.

In addition many employees are able to take PIP awards in the form of vacation time. Other regular workers needed to fill in on an overtime pay basis add further hidden and additional costs attributable to the PIP program.

Early Incentive Retirement Plan

The Early Incentive Retirement Plan was adopted by the BOS in December of 2002. This plan covers specified classifications of employees of some of the larger County agencies who are not defined as safety personnel. The plan was represented to the BOS as saving the County \$2.6 million in Year 1; \$1.6 million in Year 2; and none thereafter. However, if only the conservative estimate of 20% of the eligible 1,085 employees affected retire, the direct cost will be over \$2.8 million to the County general fund in the first year alone and not a \$2.6 million savings.

To arrive at the cost savings figures, CEO Human Resources Office assumes that no employees retiring would be replaced within an eighteen-month period. Numerous

interviews with agency directors indicate that this assumption is highly suspect for its veracity, if not in fact false. They must be replaced immediately if the jobs are to be done.

Annual Leave

In Fiscal Year 2001-2002 a negotiated agreement between the County and the unions eliminated sick leave and vacation leave by combining them into one annual leave balance. Employees now accumulate a set number of hours of leave each year, regardless of the nature of the absence. This total time may be used at the discretion of the employee for time off, or may be cashed out partially, or in full, at separation/retirement based on a combination of the employee's account balance and the number of years service. This policy eliminates the need to verify absences due to illness and also provides the employees more flexibility in managing their vacation and sick time. The intent of this new benefit is to encourage increased production hours by the use of less sick/vacation time, because it could be recouped partially at separation/retirement. Some department managers point to the fact that this new policy is not always having the intended effects. Employees when seeing one large accumulated annual leave balance have opted to take additional time off. Thus, an unintended effect of this policy change has been a higher level of employee absence.

The Annual Leave benefit for the Orange County Employee Association (OCEA) and the Service Employee International Union (SEIU), who together number approximately 13,500, was adopted by the BOS on November 5, 2002, as Agenda Item Transmittal (AIT) #60 as part of the consent calendar. Theoretically, consent items must be under \$500,000 in amount. Had this item been carefully analyzed and accurately presented to the BOS by CEO Human Resources Office, it would not have met this criteria. The AIT for this board action is clearly marked as "N/A" for cost and is signed by the CEO Human Resources Office and the County CEO Office respectively. This representation to the BOS was clearly in disagreement with Auditor-Controller Office of Orange County, whose counsel and advice was ignored by CEO Human Resources Office and the County CEO Office. When existing sick leave balances were converted, an immediate cost of \$29.5 Million was incurred according to the 2002 Comprehensive Annual Financial Report (CAFR).

Human Resources Steering and Oversight Committee

Recently a concerned group of high level County officials and agency heads recognized that a potentially serious problem threatened the County's fiscal future if the trend of wage and benefit increases continued without thorough determination of their impact. They proposed that a steering committee guide the CEO Human Resources Office in their actions in these areas. While this proposal was first rejected out of hand by the then CEO Office, the idea has recently been viewed in a more favorable light by the BOS. A recent letter from the BOS states, "*The impacts of the human resources department's decisions are profound and far-reaching, and in need of oversight and direction.*" The BOS now seems to be moving forward with the formation of the previously recommended Human Resources Steering Committee.

FINDINGS:

Under *California Penal Code* Section §933 and Section §933.05, responses are required to all Findings. The Orange County 2002-2003 Grand Jury has arrived at five Findings:

1. Two Orange County supervisors recommended in February 2003 that a Human Resources Steering and Oversight Committee be formed to provide oversight and direction.
2. Operational capabilities of some departments are being adversely affected and they are forced to eliminate some existing programs due to cost increases in wages and benefits.
3. Some affected departments/agencies management had little or no participation or input in the negotiations with bargaining units.
4. Proposed increases in benefits and wages are not thoroughly and accurately costed out prior to offering them to bargaining units or presented to the B.O.S.
5. Orange County has recently established a pattern of ever expanding and increasing payroll and related benefits spending. This pattern is counter to the model of cost cutting in private industry and is vitally significant during periods of uncertain or diminished economic outlook.

Responses to Findings 3 and 4 are required from the Auditor-Controller

Responses to Findings 1 through 5 are required from the Board of Supervisors

RECOMMENDATIONS:

In accordance with *California Penal Code* Section §933 and Section §933.05, each Recommendation must be responded to by the government entity to which it is addressed. These responses are to be submitted to the Presiding Judge of the Superior Court. Based on the findings, the 2002-2003 Orange County Grand Jury recommends that:

1. The Orange County Board of Supervisors follow through on Human Resources Steering and Oversight Committee to oversee the County's Human Resources labor negotiating activities implementing its recommendations. (Finding 1)
2. Require that prior to passage, all new wage and benefit initiatives receive review by the Auditor-Controller with input and review by the Chief Financial Officer and by any affected department. This review should be required prior to submittal of all wage and benefit proposals to the County Executive Officer or the Board of Supervisors for approval. (Finding 4)
3. The Auditor-Controller, Chief Financial Officer and affected departments should have greater participation and input to the negotiations with bargaining units. (Finding 3)
4. Consider renegotiating certain pay and employment benefits that have become increasingly costly. (Finding 2 and 5)

Responses to Recommendations 2 and 3 are required from the Auditor-Controller.

Responses to Recommendations 1 through 4 are required from the Board of Supervisors.

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 9. Orange County Employee Retirement System Results of AB 1937 Analysis, November 2, 2000.
 10. Orange County Merit System Selection Rules and Appeals Procedure.
 11. Performance Incentive Program (PIP) Manual Revised 2002.
 12. Personnel and Salary Resolution, June 29, 2001.
 13. Thirteen Memoranda of Understanding between Orange County and Recognized Labor/Employee Organizations.
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