

TESTIMONY BY KALBERT K. YOUNG
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON FINANCE
ON
SENATE BILL NO. 2424, S.D. 2, H.D. 2

April 4, 2012

RELATING TO PROFESSIONAL EMPLOYER ORGANIZATIONS

Senate Bill No. 2424, S.D. 2, H.D. 2, establishes a Professional Employer Organization Special Fund into which shall be deposited the funds from applications, registrations, and penalties from professional employer organizations which will be used by the Department of Labor and Industrial Relations to administer and enforce the provisions of Chapter 373L, Hawaii Revised Statutes. The bill further establishes three .50 positions and appropriates an unspecified amount of funds for FY 13 to administer the program.

While the Department of Budget and Finance does not take any position on the professional employer organization program, as a matter of general policy, the department does not support the creation of special funds which do not meet the requirements of Section 37-52.3, Hawaii Revised Statutes. Special or revolving funds should: 1) reflect a clear nexus between the benefits sought and charges made upon the users or beneficiaries of the program; 2) provide an appropriate means of financing for the program or activity; and 3) demonstrate the capacity to be financially self-sustaining. In regards to Senate Bill No. 2424, S.D. 2, H.D. 2, it is difficult to determine whether the special fund will be self-sustaining. In addition, the

bill does not address or appropriate general funds to allow the Department of Labor and Industrial Relations to expend funds for personal services and other operating costs necessary to start-up the registration of professional employer organizations.

I encourage the Legislature to scrutinize the fiscal and operational plan for this program to ensure that it does conform to the requirements of Section 37-52.3, Hawaii Revised Statutes.



**STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS**

830 PUNCHBOWL STREET, ROOM 321
HONOLULU, HAWAII 96813
www.hawaii.gov/labor

April 4, 2012

To: The Honorable Marcus R. Oshiro, Chair,
The Honorable Marilyn B. Lee, Vice Chair, and
Members of the House Committee on Finance

Date: Wednesday, April 4, 2012
Time: 2:30 p.m.
Place: Conference Room 308, State Capitol

From: Dwight Y. Takamine, Director
Department of Labor and Industrial Relations (DLIR)

Re: SB2424 SD2HD2 RELATING TO PROFESSIONAL EMPLOYER ORGANIZATIONS

I. OVERVIEW OF PROPOSED LEGISLATION

Overall, the department is supportive of the measure. The current draft combines two separate chapters in the Hawaii Revised Statutes (HRS) relating to professional employer organizations. The department's biggest concern with the proposal is ensuring that the fees established in the measure are sufficient to support the staffing and resources necessary to carry out the purposes of the proposal.

At this time, it is difficult for the department to forecast the workload required by this measure and the three (3) .5 positions may not be sufficient to carry out the purposes of this new chapter, especially considering that the measure creates a new hearings process. Moreover, the department notes that usually a new special fund is "seeded" with a general fund appropriation to help establish the positions and operations to be funded by a special fund.

III. COMMENTS ON THE SENATE BILL

DLIR respectfully offers the following comments and recommendations for your consideration in regards to the current draft of the proposal:

- ❖ DLIR is concerned that the proposed registration requirements in the proposal may serve as an effective barrier to new entrants into the market; therefore, the department suggests amending 373L-2(b)(12) in two ways:

1. Insert "within 3 months of registration or renewal" between "audited" and "by" on Line 8, Pg. 18.
2. A new subsection as follows: (ii) If the professional employer organization has not had sufficient operating history to have audited financial statements, financial statements that have been reviewed within 3 months of registration by an independent certified public accountant licensed to practice in the State who attests that the professional employer organization has \$150,000 in working capital; and

(This \$150,00 amount is from Connecticut's law)

- ❖ DLIR also suggests that clarifying language should make clear that the department can go in immediately to the court to get an injunction, if necessary, and not have to wait 30 days. Proposed language for 373L-3(f) as follows:

~~[(e)]~~ (f) Failure to have in effect a current bond shall result in automatic forfeiture of registration pursuant to this chapter and shall require the professional employer organization to immediately cease doing business in the State. Notwithstanding section 373L-H, if the professional employer organization does not cease doing business, the director may immediately apply to the court for an order to enjoin the professional employer organization. A professional employer organization whose registration is forfeited shall apply as a new applicant for registration in order to resume business in the State.

- ❖ DLIR strongly supports a single fee, as in the current draft, as opposed to dividing fees into an initial and biennial renewal fees. The department is concerned that the division of fees into an initial registration and subsequent biennial renewal may provide a loophole for entities to avoid paying the graduated biennial renewal fee. An entity, especially a large sized one, could change corporate information, including its name, and be eligible to register as a new PEO and pay the much lower initial fee as opposed to the larger fee under consideration.
- ❖ We suggest a sliding scale as follows:

○ 0-100 employees	\$2,000
○ 101-250	\$5,000
○ 251-499	\$7,500
○ 500+	\$15,000



April 4, 2012

The Honorable Marcus Oshiro, Chair
Finance Committee
State Capitol
415 South Beretania Street
Honolulu, Hawaii 96813

Re: SB2424 Relating to Professional Employer Organizations
April 4, 2012, 2:30 pm, CR 308

Dear Representative Oshiro:

I would like to thank you and your committee for your efforts to implement PEO registration. My name is Barron Guss, President and second-generation owner of ALTRES, Inc., a 43-year old Hawaii company and Hawaii's oldest Professional Employer Organization. I am here today to provide testimony in support of SB2424 with modification

By way of background information, recently our industry representatives have worked hand in hand with legislators, the DLIR, DCCA and other government leaders to create the framework of the draft in its current form. Although it's not perfect, I feel we are making positive headway towards a bill with which we all can live.

Because of the complexity of the subject matter, I am submitting my comments in topic format so they may be easily followed and referred to during the legislative process.

Responsibilities

In recent discussions with various parties, we have brought up the concern that PEOs cannot assume all of the responsibilities associated with being the employer; i.e., payment of wages, taxes and insurances, unless their clients provide the funds to do so. Additionally, the way the draft law is written, if the PEO were made specifically responsible for the provision of workers' compensation, would there be a question as to whether the exclusive remedy provisions apply, even though the Hawaii Supreme Court ruled affirmatively on this very matter in Peter Frank vs. Hawaii Planing Mill Foundation?

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For purposes of clarity, may I suggest that Section 373-L-F be revised to read as follows:

Section 373-L-F - **Professional employer agreements.** The agreement between a professional employer organization and its client company shall state that the professional employer organization shall be deemed the employer for purposes of unemployment insurance, workers' compensation (and the exclusive remedies provision of Chapter 386 shall apply to both the client and the professional employer organization with respect to workers' compensation coverage secured by the professional employer organization), temporary disability insurance, and prepaid health care coverage, providing the client company meets its obligations under the Professional Employer Organization agreement.

Fees

Paragraph 373L-D provides that the Director "shall collect fees pursuant to this chapter." In previous drafts of SB2424, the various parties reached a compromise which appeared to be acceptable to all parties. In this current draft, the level of fees has been omitted and left open-ended. May I suggest that your committees reinsert the fees to the previous levels.

Bond Requirements

In previously submitted testimony, I suggested the use of the State's form UC-B6, Quarterly Wage, Contribution and Employment and Training Assessment Report for a basis of calculation regarding registration fees as well as bonding level requirements.

By using the information contained in UC-B6, the DLIR will have in hand a simplified way to gather and calculate the information necessary to establish the appropriate schedules for payment of fees and bond level, versus the current-draft of the law, which requests information that must be gathered from various sources and, in some cases, is not applicable, i.e., a self-insured PEO that does not pay workers' compensation premiums to a third party carrier.

In light of the above, may I suggest that the following language be inserted in 373L-3 Paragraph (2):

"All other professional employer organizations shall post a bond in an amount equal to one percent of the organization's prior year's total wages or a bond amount of \$1,000,000, whichever is

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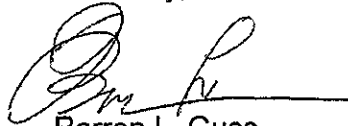
less; provided that the amount of the bond shall be no less than \$500,000. The bond amount, for the purposes of this section, shall be calculated based on the total gross payroll as reported on the professional employer organization's fourth quarter form UC-B6: Quarterly Wage, Contribution and Employment and Training Assessment Report filed with the department of the preceding year, annualized."

Assurance Organization and Bonding Language

Under separate testimony from ESAC, you will hear that the draft language is not in conformity with standard practices and protocol currently used in the financial industry as well as other states that have enacted registration. I ask that you please take their comments into consideration as you move this bill forward.

Thank you for this opportunity to provide testimony and comment on this proposed legislation.

Sincerely,



Barron L. Guss
President and CEO

BLG:lo

TAXBILLSERVICE

126 Queen Street, Suite 304

TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Professional employer organizations; special fund

BILL NUMBER: SB 2424, HD-2

INTRODUCED BY: House Committees on Consumer Protection and Commerce and Judiciary

BRIEF SUMMARY: Amends HRS section 237-24.75 to replace the term “professional employment organization” with “professional employer organization” and the term “assigned employees” with “covered employees.” Clarifies that the general excise tax exemption shall not apply to a professional employer organization if: (1) employees are excluded from any rights or benefits required by law to be provided to employees of the client company; or (2) the professional employer organization fails to pay any tax withholding for covered employees or any federal or state taxes for which the professional employment organization is responsible.

Repeals and merges HRS chapter 373K into chapter 373L. Transfers the statutory language delineating the general excise tax exemption including the requirement that employee benefits required by law be provided to employees of the client company by the client company from HRS 373K to chapter 373L and replaces the term “professional employment organization” with “professional employer organization” and the term “assigned employees” with “covered employees.”

Adds a new section to HRS chapter 373L to establish a professional employer organization special fund to be administered by the department to implement and operate the registration of professional employer organizations established by this chapter. Moneys collected as fees or fines under HRS sections 373L-B, 373L-C, 373L-D, and 373L-G shall be deposited in the fund. The fund may be expended for personnel and operating expenses and staff training.

Allows the director of labor and industrial relations (DLIR) to establish additional positions to carry out the purposes of HRS chapter 373L.

Appropriates \$ _____ out of the professional employer organization special fund for fiscal 2013 to DLIR for the purposes of this act, including the hiring of additional staff. The appropriation shall take effect on July 1, 2012.

EFFECTIVE DATE: July 1, 3000

STAFF COMMENTS: In 2007 the legislature, by Act 225, established HRS chapter 373K to provide that amounts received by a professional employment organization from a client company in the course of providing professional employment services that are disbursed as employee wages, salaries, payroll taxes, insurance premiums, and benefits are exempt from the general excise tax. While in 2010, the legislature, by Act 129, established registration requirements for the professional employer organizations and established a new HRS chapter 373L, this measure merges HRS chapter 373K into chapter 373L, including the provisions delineating the general excise tax exemption.

While the measure also proposes to establish a professional employer organization special fund, it should be remembered that the 1990 legislature directed the State Auditor to evaluate all special and revolving funds as of July 1, 1990 and recommend whether they should be continued or eliminated. The Auditor is also to examine any new or proposed special or revolving funds that would decrease general fund revenues. While the Auditor had a completion date of 1995, the review was completed in 1992. The Auditor's report noted that, "Special funds give agencies full control of these unappropriated cash reserves, provide a way to skirt the general fund expenditure ceiling, and over time erode the general fund. Many experts say that special funds are likely to hamper budget administration. And from a legislative perspective, they are less desirable because they are not fully controlled by the appropriation process."

Given the findings of the Auditor and the current financial crisis, it is quite clear that the creation of numerous special funds has eroded the integrity of state finances. Moneys in special funds are neither subject to the general fund expenditure limitation nor to the close scrutiny that general funds are subject to in the budgeting process. Special funds that earmark general fund revenues cannot be justified as they restrict budget flexibility, create inefficiencies, and lessen accountability. Further, as evidenced by recent legislative sessions, special funds have been raided in the search for additional revenues. The creation of another special fund by this measure cannot be justified.

Digested 4/4/12



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