February 11, 1998
ILR 98-B

President R. Lane Beattie, Co-chairman
Speaker Melvin R. Brown, Co-chairman
Members of the Audit Subcommittee
State Capitol Building
Salt Lake City UT 84114

Subject: Consulting Contracts and Severance Pay for Departing Directors

Dear Legislators:

As requested, we have collected information regarding consulting contracts that several state departments granted to their former directors. During 1997, the state paid about $36,000 to six executive level employees who left their positions for various reasons. In each case, the contract period commenced immediately upon termination from state employment and lasted about a month. The contract amounts were based on the individuals' prior salary. Each of the six contracts is discussed in more detail later in the report. The two main questions we addressed were:

- Were the consulting contracts appropriately issued and did the state receive full value under the contracts or should some part of the contract payments be considered severance pay?

- Did any of the departing directors receive both a consulting contract and severance pay?

We addressed these questions by reviewing available documents, including the contracts and payment invoices. In addition, we interviewed current departmental personnel about the contracts as well as state human resource and purchasing directors. We also discussed the contracts with the governor's two former chiefs-of-staff. Our work also included a review of state severance pay policy.

During our review we noted that, in general, the consulting contracts with departing directors may be an effective tool to provide management continuity during transition periods, but the value that the state received in the form of actual services from them is uncertain and it is therefore difficult to differentiate between some of the contracts and severance pay. Furthermore, we discovered inconsistencies in the way that the contracts were paid, which in certain instances was problematic. We did, however, find that none of the directors who had contracts received any severance pay upon termination. While reviewing the state's severance pay policies, we found that without clear legislative intent language there is some ambiguity about when severance should be paid. We also found that the state is now exposed to a significant and growing financial burden because of current severance pay policies.

The remainder of this report will provide further detail on our review of consulting contracts with departing directors, the inconsistencies in how those contracts were paid, and the history surrounding the development of severance pay as a benefit to some exempt executive employees.

Value of Consulting Contracts Is Uncertain

The consulting contracts that we have reviewed were a reasonable method to manage administrative transitions within the organizations; however, the value that the state received from the contracts remains uncertain. Furthermore, typical payment procedures which usually include a contractor submitting an invoice of work performed before payment is made were not followed in all cases. In fact, we found inconsistencies in how four contracts were handled for payment by different departments and then more inconsistencies in how the same department paid for services under two of the contracts.

During 1997, four department directors who resigned their positions and two Industrial Commissioners whose positions were discontinued entered into consulting contracts with their former departments. Generally, the contracts stated that the former employees were required to "*...provide consulting services to the department...during the term of (the) contract...*" and specified the maximum amount that could be paid for those services. According to the governor's former chief of staff, the purpose of each of the first four contracts was to provide the organizations with executive consulting services, if needed, during a transition in departmental administrations. The last two were intended to allow the outgoing commissioners to complete ongoing projects after their terms expired. The following figure provides a summary of the general conditions of each of the six contracts.

Figure I
Summary of Consulting Contracts

Former Director	Agency	Maximum Contract Amount	Actual Amount Received	Length of Contract
D.Douglas Bodrero	Dept of Public Safety	$ 6,300.00	$ 6,300.00	1/01-1/31/97
Joseph A. Jenkins	DCED	8,000.00	6,514.50	1/01-3/05/97
Robert E. Wilcox	Dept of Insurance	6,187.00	6,467.60	1/01-1/31/97
O.Lane McCotter	Dept of Corrections	8,046.00	8,046.00	7/13-8/16/97
Thomas R. Carlson	Labor Commission	5,599.44	3,337.50	7/01-7/31/97
Colleen S. Colton	Labor Commission	5,599.44	5,599.44	7/01-7/31/97

1. **D. Douglas Bodrero:** Mr. Bodrero resigned as the Commissioner of Public Safety effective January 1, 1997. Since his replacement had not been selected, the department was functioning under an interim director in January 1997. In order to assist the department during this transition period, the governor's office requested that the Department of Public Safety (DPS) enter into a consulting contract with Mr. Bodrero subsequent to his resignation. This contract obligated the former commissioner to be available to the department 24 hours a day between January 1 and January 31 should they ever need his advice or help. He was not obligated to go into the office every day during that time period, but was rather only required to provide assistance if and when he was called upon. According to the person who drafted the contract, the contract amount of $6,300 was based on the average number of work hours in a month (160 hours or 20 days) multiplied by Mr. Bodrero's hourly rate at the time he left the department.

   It was reported that Mr. Bodrero provided assistance to the department in some non-appropriation legislative committee meetings. Additionally, current employees in the department also recall that Mr. Bodrero did meet on occasion with the interim director during January. Unfortunately, there is no other documentation demonstrating what value to DPS or the State of Utah resulted from this contract. Furthermore, Mr. Bodrero did not submit an invoice attesting to his fulfillment of the contract and requesting payment. Instead, DPS submitted an invoice to itself on behalf of Mr. Bodrero stating that the terms of the contract had been fulfilled and requesting that payment for the maximum contracted amount be made to him. Based on this invoice, Mr. Bodrero was paid $6,300 in one lump sum at the end of the contract period.

2. **Joseph A. Jenkins:** Mr. Jenkins resigned as Director of the Department of Community and Economic Development (DCED) effective January 1, 1997. Again, at the time the resignation became effective the Governor had not yet appointed a replacement for Mr. Jenkins. Unlike the DPS, in this instance, the Governor had not appointed an interim director to serve during the transition. As a result, Mr. Jenkins also entered into a consulting contract with his former department in order to provide management help until a replacement was appointed. Although the original contract period was only for the month of January, it was later altered to extend into March as more help was needed. The maximum amount payable by the contract was $8,000. This amount was not based on any set formula. Instead, DCED personnel simply estimated an amount high enough to cover any costs they might incur, since the amount of work that would actually be needed was unknown.

   According to DCED employees, during the beginning of his contract Mr. Jenkins actually came into the office and worked full days on administrative tasks just as he had done prior to his resignation. After awhile he came in to work for intermittent part-days. It was also reported that Mr. Jenkins met with the legislative appropriations committee on behalf of the department. Although there was really no other tangible evidence as to how DCED benefitted from the work performed under this contract, at the end of his contract Mr. Jenkins did submit an invoice to DCED for 21.5 days of pay based on the time he had spent on state work. Mr. Jenkins was paid a total of $6,514.50, based on his prior state salary of $303 per day, for the time he spent on state work during his two month contract period.

3. **Robert E. Wilcox:** Mr. Wilcox, former Commissioner of Insurance, was another executive director who resigned effective the first of January, 1997. Though at the time no replacement had been announced for this position, an interim director was appointed beginning January 1st. As in the above situations, the Governor's office felt the department needed to have assistance available to them during the transition between administrations. A contract was signed providing for a maximum payment of $6,187 (22 days pay at his former pay rate) for services during the month. Uncertain of how to handle the payment of these transitional services, the department's administrative manager decided to re-hire Mr. Wilcox as a temporary employee at his executive level wage for a month after his resignation took effect. In this position, Mr. Wilcox was required to make himself available to the department 24 hours a day.

According to current employees of the Insurance Department, Mr. Wilcox occasionally met with the interim director regarding some complicated insurance company liquidations that were occurring at the time. Additionally, Mr. Wilcox spoke with a couple of other employees regarding various administrative issues. However, there is no documentation attesting to any specific work that was performed by Mr. Wilcox and we are uncertain as to the value that the state received from his temporary employment with the Insurance Department.

Because of his status as a temporary employee of the Department of Insurance, Mr. Wilcox did not have to submit an invoice in order to be paid for fulfilling the terms of his employment. He was paid through the state's temporary payroll system; although this system requires the department to submit a document to the Division of Finance indicating the number of hours for which Mr. Wilcox was to be paid. The intention of Mr. Wilcox's employment was only to require him to be available to the department if they needed him and not to necessarily have him work a certain number of hours. This being the case, they merely claimed his hourly rate for 40 hours a week, including 2 holidays, from January 1 to January 31, totaling $6,467.60 plus temporary state-paid benefits (FICA, Workers' Compensation, and Unemployment Insurance). The department admits that Mr. Wilcox did not work 40 hours per week during that time period, but because he was hired as an employee and not a contractor, payment had to be requested in the form of hours and not in dollars.

4. **O. Lane McCotter:** Effective July 13, 1997, O. Lane McCotter resigned from his position as the Director of the Department of Corrections. Once again, the Governor's office anticipated that some time would pass before they would be able to appoint a replacement. Hence, the Governor's office felt it appropriate to negotiate a consulting contract with Mr. McCotter for the provision of transitory consulting services. A contract was signed providing for a maximum payment of $8,046 (25 days pay at his former pay rate) for services during the 5-week period.

   We have not been able to confirm whether or not Mr. McCotter provided any services to the department, either for the interim or replacement director. Neither Mr. McCotter or the department prepared or submitted an invoice attesting to the fulfillment of the contract to request the appropriate payment. Thus, it is impossible for us to determine whether or not there was any actual value to the department or the state by having this contract. On the other hand, because his contract only required him to be available and did not require any actual work to be performed, it does appear as though he fulfilled the contract. Under the terms of the contract, Mr. McCotter was paid on a bi-weekly basis at his regular rate of $3,218.40 without requiring any documentation other than the contract. By the end of his five week contract, Mr. McCotter had been paid

$8,046.00.

5. **Thomas R. Carlson:** Mr. Carlson's position as an Industrial Commissioner was eliminated by new statute effective July 1, 1997. Recognizing that Mr. Carlson needed to complete several key projects, the newly formed Labor Commission entered into a consulting contract with him in order to complete these projects. His contract allowed for the maximum payment of $5,599.44, which was equivalent to 21 days of pay at his former pay rate for the services provided during the contract period.

   It was reported to us that for approximately one month Mr. Carlson came into the office almost on a daily basis to work on these projects. He kept a record of all the time he worked and at the end of the contract period he submitted this record for payment. As noted on his records, he had worked 66 3/4 hours during the contract period and he submitted his time sheet to be paid only for that amount of time. The Labor Commission paid Mr. Carlson at a negotiated rate of $50 per hour worked for a total of $3,337.50. Although Mr. Carlson's prior wage rate was $33.33 per hour, the contract was paid at the $50 per hour rate because benefits previously received while employed were no longer paid. As was the case with Mr. Jenkins, the Labor Commission only paid for the actual time that Mr. Carlson spent performing state work.

6. **Colleen S. Colton:** Ms. Colton's position as Industrial Commissioner was also eliminated by statute effective July 1, 1997. According to the Governor's former Chief of Staff, Ms. Colton needed to be retained for one month in order to complete some projects requiring her expertise. Her contract allowed for the maximum payment of $5,599.44, which was equivalent to 21 days pay at her former pay rate for the month of the contract.

   Labor Commission employees asserted that Ms. Colton did not do any work in the office but noted that they sent a computer home with her to use during her contract. She reportedly spent time reviewing the commission's old rules to ensure that they coincided with new statute. Although she was asked to submit documentation similar to that submitted by Mr. Carlson, she never did and only verbally reassured the commission that she had worked more than her contract would allow her to be compensated for and so, therefore, she felt she was due to be paid the entire maximum amount stated in the contract. Officials at the Labor Commission determined that the contract could not be paid without some sort of documentation and an invoice requesting payment for the full amount of the contract was made by the Commission in behalf of Ms. Colton. At the end of her contract she was paid the contracted maximum amount of $5,599.44.

State's Benefit From Contracts Is Uncertain

While the contracts may have provided important transition services to the state, there also could have been an element of severance pay in some cases. According to current and former members of the Governor's staff, these contracts were an appropriate use of an effective management tool. In all six cases, our review of the contracts indicates that the use of consulting contracts in assisting departments during an administrative transition or between administrations appears to be justifiable; although there are several states such as New York, Missouri, and New Mexico, that have tightened their state ethics laws to prohibit any public servants from contracting with their former employers for a certain amount of time. These contracts are legal in Utah, but unfortunately most of the contracts lack an audit trail showing how the state actually benefitted from the over $36,000 paid under these contracts. We were unable to determine if these contracts were indeed compensation for work done or rather a monetary reward for past service (what some would consider a type of severance pay).

Although our review has found that it appears as though all terms of the contracts were met and authorization for payment was justified, we found it troublesome that typical procedures of contractors being required to submit invoices regarding services rendered were not always followed by departments when administering contracts with their former directors. Standard purchasing procedures dictate that contracts are paid by an agency when they receive documentation indicating that all of the terms of the contract have been fulfilled. In only two of the above cases did this actually occur. In our opinion, it is reasonable that directors and former directors be held to the same standard that is set for any other employee or contractor who is requesting payment from a public agency. By adhering to this standard, there is a greater assurance that efforts are being made to balance the public's interest in guarding against impropriety with the former employee's interest in employment and the government's interest in hiring knowledgeable people.

Severance Pay Policies Raise Concerns

Besides the issue of whether the state received value from these consulting contracts, the audit request also asked whether any individuals received severance pay in addition to their contract payments. We found that none of the six individuals met current state eligibility requirements for severance pay and in no instance were any severance benefits paid to these individuals. However, while reviewing the state's severance pay practices in regards to this question, we found three areas of concern. First, although severance pay policy has evolved rapidly since 1994, legislative intent is uncertain. Second, guidelines regarding eligibility for payment of severance benefits to some exempt employees have, on occasion, been applied inconsistently. Third, current severance pay guidelines expose the state to a potentially large financial burden. In fact, while prior to 1994 the state had no liability for severance payments, current exposure exceeds well over $2.4 million; an amount that grows as individuals continue to accrue eligibility.

Human resource officials and other public administrators have indicated to us that severance benefits are routinely paid in the private sector by organizations trying to attract the best employees. Severance pay is attractive to potential employees because it will provide them with a financial cushion should their employment involuntarily end. According to the state's former Chief of Staff, *"...when you come to work for state government, you know there is a limited time you are going to serve. This is not a permanent position, and there needs to be some kind of transition out of government service."* We also found other public entities, besides the state, that have incorporated severance benefits into their personnel practices. For instance, even though Salt Lake County does not have any severance benefits, Salt Lake City does provide severance benefits to executives in appointed positions who are involuntarily terminated from services without cause. These executives are eligible to be paid the equivalent of one month's salary for each year of service in an executive position up to a maximum of six month's pay.

What is Legislative Intent on Severance Pay?

Because of how severance pay policy has evolved, legislative intent concerning severance pay is uncertain. Until 1994 there was no administration of severance pay within the executive branch of Utah state government. Beginning in 1994, severance benefits began to take form within state personnel practices, first as an incentive for a limited number of individuals to convert from career service to exempt employment status, then as an expanded benefit for all executive employees who fell within certain exempt schedules. Two pieces of legislation are involved in the legal evolution of state severance pay policy.

Although it did not specifically mention severance pay, **House Bill 330** from the 1994 legislative session led to its establishment. The purpose of the legislation was to enable the Governor to more effectively implement state policy by having more direct control over key state positions. HB 330 expanded the definitions of executive exempt positions by modifying the Schedule AD definition and creating the Schedule AR exemption. As a result, some positions that had previously be classified as Schedule B (career service) were reclassified as exempt. The individuals then occupying the affected positions were not forced by the legislation to give up their career service status. Instead, HB 330 directed the Department of Human Resource Management (DHRM) to establish a set of incentives to encourage those employees to voluntarily leave the more secure employment status of the career service system and accept the riskier status of an exempt employee who serves at the will of the appointing official. One of the incentives selected was severance pay equal to one week of pay for every year of state service unless discharged for cause, or voluntarily separated or retired from state service.

The second piece of legislation relating to severance pay policy was **House Bill 217**, in 1995, which directed that Schedule AB employees (department heads and commissioners) were eligible for *"the same severance pay available to the other non-career service employees."* Prior to this bill being passed, executive branch officials had previously decided that it was unfair for individuals in some schedule AD and AR positions to be eligible for severance pay (i.e., those who converted under HB 330) while those in other AD and AR positions were not. Therefore, at the same time that employees signing conversion contracts were becoming eligible for severance benefits, severance pay was extended in practice to all employees in those two schedules (not just those with contracts). HB 217, which is the only legislation that specifically mentions severance pay, established that the higher level AB positions were now eligible for whatever severance benefits were available to the employees under their direction.

Currently there are three groups of employees covered by state severance pay policy:

1. **Conversion Contract Employees.** There are currently 27 employees with contracts that obligate the state to pay them severance pay equal to one week of pay for every year of state employment if they are discharged without cause. These employees elected to convert under the provisions of HB 330 (1994) and signed a contract relinquishing their career service status in exchange for certain incentives including severance pay.

2. **All Other AD and AR Schedule Employees.** About 358 additional schedule AD or AR positions are eligible for severance pay equal to one week of pay for each year served since 1993. Nineteen of those positions still have career service employees, who are not eligible for severance benefits, serving in them and there are another 28 positions that are currently filled with employees eligible for retirement and therefore are not eligible for severance either. Thus, only 311 of the 358 positions are filled by employees who are potentially eligible for severance pay. As mentioned above, because the conversion contract employees also served in AD or AR positions, executive branch officials felt that the severance pay benefit needed to be extended to provide fair treatment of all similarly situated individuals. DHRM's legal advisor in the Attorney General's office told us the conversion incentives were legally different than benefits and therefore the decision to extend the severance benefit was based on policy rather than legal considerations. Because there was no legislation related to the policy decision to extend the severance benefit eligibility, we are unsure whether it is consistent with legislative intent.

3. **AB Schedule Employees.** Severance pay eligibility was extended to another 48 schedule AB positions by the 1995 Legislature. HB 217 provided that these department heads and commissioners should be eligible for whatever severance benefit their subordinates received. Thus, employees in AB positions are potentially eligible for severance pay equal to one week of pay for each year served since 1993. However, only 45 of the 48 AB employees are currently eligible for severance pay because 3 of them are eligible for retirement.

In summary, since 1994, state severance pay policy has evolved so that there are now 433 exempt positions that qualify for severance pay unless the employee in one of those positions has retained his or her career service status, is eligible for retirement, resigns, has a term that expires, or is fired for cause. The six former directors or commissioners that we discussed in the previous section did not qualify for severance pay because four resigned and the other two had terms expire (they were statutorily terminated). Those individuals that do qualify for severance would receive one week of pay for each year served since 1993 except for the 27 employees with conversion contracts who are potentially eligible for one week of pay for each year of state service without limit. In the absence of clear legislative intent, executive branch officials have placed various limits on severance pay as questionable instances arose. As we will discuss below, there are two issues that we feel need to be addressed: 1) the conditions under which severance benefits should be paid, and 2) the amount of the state's exposure to severance pay-outs.

Under What Conditions Should Severance Be Paid?

According to DHRM officials, the state severance pay policy benefits both the state and the eligible employees since quite often in government a forced separation of employment may not have anything to do with competency. Having a severance pay policy helps the state attract the most qualified individuals to its workforce. When shifting policy forces competent individuals from their positions, severance pay provides them a financial cushion while they seek other employment. DHRM has established and amended state personnel rules to meet these objectives so that severance is not paid in unintended situations. However, we feel additional procedures may be needed to better control severance payments.

As indicated, DHRM has made changes to state severance rules to implement a more effective severance pay policy. For example, during 1997 two major changes were made in response to concerns about who was receiving severance benefits and how much they were receiving. In 1995 and 1996 two commissioners whose terms expired and were not reappointed received severance payments of $20,472 and $16,381 based on 15 and 11.3 years of qualifying state service. Eligibility for severance benefits was not intended by DHRM officials to apply to someone whose term has simply expired. In June 1997, DHRM updated their rules to eliminate severance eligibility for employees whose *"...statutory term has expired without reappointment...."* Furthermore, there was a concern that the payment amounts were too large. Therefore, a second major change to the Rules in 1997 was a limitation as to when employees could begin accruing years of eligibility for calculating severance benefits. Instead of being eligible for one week of pay for every year of service in the executive branch, now severance pay is based on years of *"consecutive exempt service accrued after January 1, 1993...."*

While the changes that DHRM made to personnel rules better control severance payments, some of the severance payments we reviewed raise additional concerns. For example:

1. **Employees That Are Quickly Rehired by the State.** In 1994, a schedule AD employee was involuntarily let go from her position with the Tax Commission and subsequently paid $19,116 in severance benefits based on her 18 years in state service. However, only one month later she was rehired by the Department of Corrections. The Governor's former Chief of Staff told us that he thought a provision had been made in the rules to require some type of repayment of paid severance benefits if the person returned to state service within a certain amount of time. However, no such provision was ever established. Thus, an employee who receives any amount of severance pay from the state is not required to return any of it even if they are hired back by the state at a later time.

2. **Employees with "Forced" Resignations.** We found two examples where employees had resigned from Schedule AB positions, which the rules consider a voluntary separation from employment making them ineligible for severance benefits, did in fact receive severance pay when they left. One employee received two weeks of severance pay, or $1,551 and the other received 8 weeks of severance pay, or $6,204. The Human Resource director who authorized both of these severance payments explained to us that both of these individuals had resigned under duress and, in effect, had been forced to leave their positions. According to DHRM officials, a forced resignation is essentially the same as an employee being involuntarily let go and therefore, the employee is eligible for severance pay.

3. **Procedures for Documenting Severance Eligibility are not Clear.** When an employee leaves state employment for any reason the employer must file a **Notice of Termination** form with DHRM. This form asks the employer to list a code that describes under what circumstances the employee is leaving (e.g., retirement, resignation, disciplinary action, layoff, other, etc.). Unfortunately, these codes are not always accurate and even when they are accurate they seem to provide no assistance to human resource personnel, either at the departmental or state level, when determining

eligibility for severance pay. In the above two instances the resignation codes had no bearing on the decision to grant severance pay. Other severance payments have been made to individuals whose termination codes included "took job with private industry" and "other" which are difficult to reconcile with severance pay policy. Severance pay policies should be applied as they are written and these termination codes could provide assistance to those determining severance eligibility. Since severance payments currently are officially approved by the individual department and not DHRM, linking termination codes with severance eligibility would increase the likelihood that severance policies are uniformly administered throughout the state.

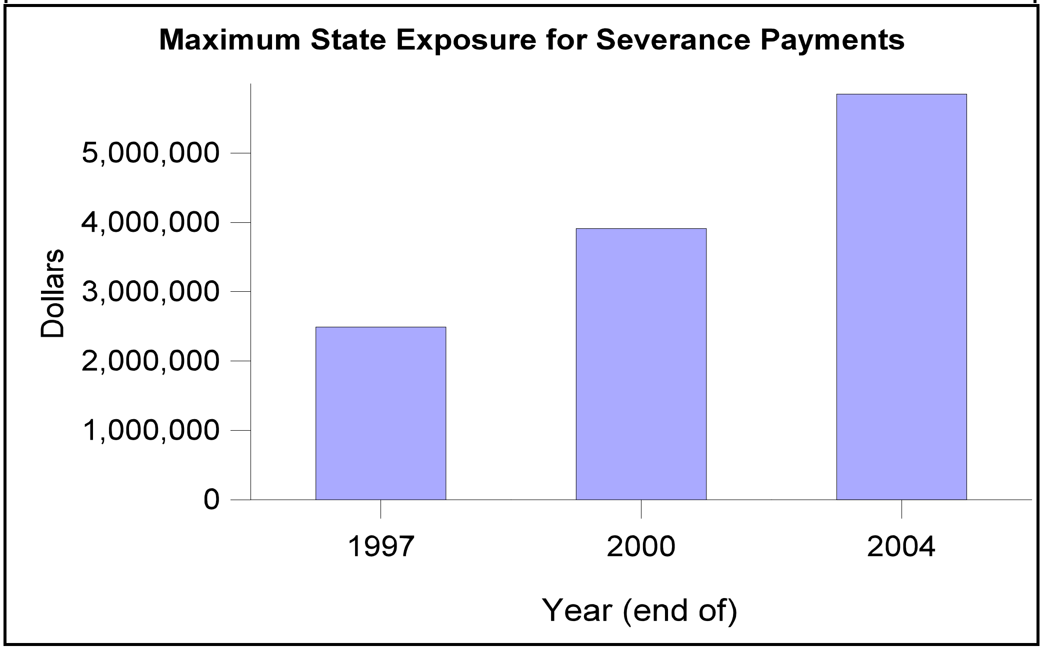
4. **Employees Exempt from Rules Could Receive Severance Pay.** While DHRM has strengthened severance pay policies so they better protect the interests of the state, some state employees are not covered by DHRM rules. **Utah Code** 69-19-12 exempts judicial, legislative, and some executive branch employees from DHRM rules. According to DHRM's legal advisor, as long as there is no specific prohibition, agencies may use severance pay as a management tool for any of these exempt employees. The judicial branch has no policies defining severance pay, but we found several instances where the courts used severance pay as part of termination agreements. There are also at least two groups of executive branch employees that are not covered by state severance rules but, according to their human resource officials, are eligible for severance pay. Although there is no written policy, schedule AC employees (the Governor's and Lieutenant Governor's personal staff) have been eligible for severance pay for at least the past few years, and reportedly on two occasions severance has been paid to AC employees. In addition, schedule AM employees (executive/professional positions in DCED) are considered eligible and DCED reports that severance pay policies are currently being drafted.

What Is the State's Financial Exposure for Severance Pay?

Our greatest concern with severance pay is the potential financial burden that it has created for the state. We found that the state's severance pay rules expose the state to a financial burden that apparently was not considered when the rules were put into place. The initial rule-making proceeding that established severance pay rules did not include a cost estimate. However, DHRM estimated that the recent rule change limiting severance eligibility to service since 1993 reduced the state's financial risk by $1-2 million. In this section we estimate the state's current and future financial exposure under existing rules. We also show how much might be paid under different assumptions about the proportion of exposure that could be realized and discuss other exempt employees not covered by rules.

Exposure under Existing Rules. Figure II shows the maximum amount of severance pay that the state could be obligated to pay to current AB, AD, and AR employees. At the end of 1997 the state was exposed to an approximate maximum financial burden of nearly $2.5 million due to the 383 exempt executive positions that are potentially eligible for severance pay and the average salary of those people currently serving in those positions. This amount includes about $534,000 that arises from the contractual obligation the state has with employees who converted from career service to exempt positions. The remaining $1.9 million arises from the decision to extend severance benefits to all AB, AD, and AR employees. About 31 exempt individuals are not included in the calculation because they are already eligible for retirement and are therefore ineligible for severance pay. However, when these individuals do leave their positions, their replacements will begin accruing their own severance eligibility.

Figure II



As shown above, by the end of the Governor's current term in the year 2000, the state's maximum exposure will have increased from the current \$2.5 million to over \$3.9 million. This estimate is based on 338 eligible employees (383 currently eligible less 45 that become eligible for retirement) accruing three more years of service and receiving annual salary increases of 3 percent. If the Governor serves another term, the state's exposure could reach well over \$5.8 million by 2004 (based on 63 additional employees becoming eligible for retirement but also assuming some earlier retirees are replaced). One factor not considered in our estimates is the potential growth in the number of exempt positions. Last year 21 new AR positions were created; as more positions become eligible for severance, the state's financial exposure increases. Today the average eligible employee would receive over \$4,900 in severance benefits if he or she was involuntarily terminated from service. By the year 2004, that same employee would then be eligible for over \$16,200 in severance pay. According to these calculations, state severance benefits, as they are currently defined, expose the state and its taxpayers to a potentially large financial burden that may or may not be understood by or acceptable to the Utah State Legislature.

How Much Severance Will Actually Be Paid in Future Years? The severance amount that eventually will be paid depends on many factors which remain unknown, including future decisions to replace at-will employees. It is unlikely that as long as the current governor remains in office there will be many severance payments made. In fact, the Division of Finance has used an estimate of only four percent of the potential payout to determine the liability for the state's balance sheet. However, a much greater payout could be required when the governorship changes. After all, the original impetus for the 1994 **H.B. 330,** which led to severance pay, was to allow the governor to have more control over who held key executive branch positions. Since a new governor may choose to make many personnel changes, it is important to consider the state's potential future exposure which grows over time as employees accrue additional years of service.

It is impossible to know exactly how many employees will be terminated without cause upon the advent of a new governor's administration. The following figure shows several possible scenarios, given different numbers of employees being let go by a new governor.

Figure III
Estimates Of Future Severance Payments to AB, AD, and AR Employees Based on Current Rules

Year	If 50% Are Let Go	If 25% Are Let Go	If 10% Are Let Go	If 4% Are Let Go
2000	$1,955,291	$ 977,645	$ 391,058	$ 156,423
2004	2,924,986	1,462,493	584,997	233,998

As seen in Figure III, there are many different calculations that can be made to estimate how much the state will actually pay to exempt employees who are terminated without cause. The above estimates are just three out of many different possibilities. However, two things are certain given current statutes and rules: 1) some amount of tax payers' dollars will be used to provide severance benefits to state employees now and in the future, and 2) the amount that potentially could be paid for severance benefits continues to increase.

Rule-exempt Employees Increase State Exposure. One element of state severance liability that we have not included in the above calculations is the potential for severance pay to be granted to other exempt state employees, such as the AC & AM schedule employees that we discussed earlier. For example, at the end of fiscal year 1997, the Division of Finance included almost $350,000 in severance pay for 75 schedule AC employees in their post-employment benefit liability calculations. Again, some portion of that total exposure may be paid out some time in the future. The severance pay policies that DCED is considering for 32 schedule AM employees could realistically add another $141,000 to the state's maximum financial exposure for severance pay. Additionally, the State Auditor's office has recommended that the Division of Finance include severance liability for all AK, AG, AN, AO, AP, and AQ employees in their post-employment benefits liability statements. This recommendation is based on statements from DHRM indicating that all of these employees are potentially eligible for severance pay.

Legislative Options. Depending on their concerns with the financial exposure or effectiveness of the state's severance pay practices, legislators may want to provide policy guidance to executive branch officials. It should be noted that legislative committee discussions have touched on severance pay issues on at least two occasions: in September 1996 when the Audit Subcommittee received a report on the implementation of HB 330, and in August 1997 when the Administrative Rules Committee discussed the six consulting contracts addressed above. However, neither committee took any action; either endorsing or suggesting changes in severance policies. If legislators now choose to provide policy guidance, three basic options include making no changes, tightening severance restrictions, or loosening severance restrictions.

- If the current level of financial risk to the state is acceptable, one option would be to retain the written guidelines as they now exist. However, DHRM should be required to strictly follow those rules that they have established and eliminate any exceptions that they have put into practice or allowed other agencies to put into practice outside of the rules.

- If the current risk level is unacceptable to the Legislature, they may consider restricting the total amount of severance pay that any one person can be eligible to receive. For example, a maximum severance amount of four weeks could be established. By limiting severance to four weeks, exposure would be reduced thereby producing a current potential savings of over $300,000. However, by the year 2000 the potential savings could reach nearly $1.4 million. The Legislature may also want to consider restricting which, if any, employees should be eligible to receive severance benefits.

- If the Legislature wants to provide greater flexibility to agencies in recruiting and managing employees, it may want to consider loosening some of the restrictions on severance pay and allow individual state agencies to determine when and who will be eligible for severance pay. For example, severance pay could be paid for all resignations, so the issue of "forced" resignations does not arise.

Recommendations:

1. We recommend that former state executives contracting with their former department be required to submit invoices for actual work performed for the state before any payments are made.

2. We recommend that DHRM better define their termination codes and determine which codes are eligible for severance pay. All state agencies should be required to adhere to those decisions.

3. We recommend that the Legislature review current rules and statutes governing severance pay to determine whether or not established severance pay practices are acceptable or need to be altered.

We hope this letter addresses your concerns. A response letter from the Department of Human Resource Management is attached. If there is any additional information you need or if you have any further questions, please feel free to contact our office.

Sincerely,

Wayne L. Welsh
Auditor General

WLW:MRJ/lm