STATE EMPLOYEE LEAVE POLICIES – SICK AND VACATION LEAVE VERSUS PAID TIME OFF

EXECUTIVE APPROPRIATIONS COMMITTEE
STAFF: GARY RICKS AND RICHARD AMON

ISSUE BRIEF

OVERVIEW

Many organizations nationwide offer employees "Paid Time Off" (PTO) instead of traditional annual and sick leave. PTO allows employees to choose how leave is used while at the same time reducing administrative complexity and potentially cutting employers' costs. The State of Utah currently offers annual and sick leave that, left unused, can accumulate over time and create an unfunded liability. A switch to PTO might allow the State to increase employee salaries now and avoid high costs later – without taking away leave benefits that have already accrued to current employees. Any such switch presents a number of legal and managerial issues, as well as some potential unintended consequences.

INTRODUCTION

The Master Study Resolution (S.J.R. 15) from the 2010 General Session included an item of study (#246) called "Vacation Leave Policies - to study and conduct an analysis of sick and vacation leave policies versus paid time off." The Legislative Management Committee assigned this study to the Executive Appropriations Committee. This report attempts to address the assigned study item by asking and answering the following questions:

1. What are Utah's current leave benefits?
2. What is Paid Time Off (PTO)?
3. Would a switch to PTO reduce administrative complexity?
4. Can a switch from current leave policies to PTO generate cost savings?
    a. What is the potential for productivity savings/improvements?
    b. How might PTO impact termination pool costs?
5. What legal and managerial questions should be answered if considering a switch to PTO?
6. What are some potential unintended consequences?
7. How might policymakers proceed?

Inasmuch as Executive Branch agencies have adopted a 4x10 work schedule, information in this report is based on a ten hour workday, four day workweek.

The report concludes that a change to PTO might indeed reduce administrative complexity and generate savings that could then be applied to current salaries. It recommends that the legal and managerial impacts of such a change be considered in a standing committee prior to implementation. It further recommends that, regardless of whether the state switches to PTO, it should begin recognizing the full liability of compensated absences and Program II leave benefits.

WHAT ARE UTAH'S CURRENT LEAVE BENEFITS?

Annual Leave

State employees earn annual leave on a graduated basis tied to longevity. Employees with less than five years of service earn four hours per pay period. With 26 pay periods per year, this amounts to 104 hours or 10.4 days annually. Workers with five to nine years earn five hours per pay period, amounting to 130 hours or 13 days annually. State personnel with ten to nineteen years of service earn six hours per pay period. This amounts to 156 hours or 15.6 days per year. Finally, employees with twenty or more years of service receive seven hours each pay period, amounting to 182 hours per year or 18.2 days annually.

Employees are allowed to accumulate up to 320 hours (32 days) of annual leave. This amount constitutes the accrual cap. Annual leave time accrued in excess of 320 hours and not used by the end of each calendar year is forfeited. Annual leave is cashed out upon termination at the employee's ending hourly rate of pay.

In Calendar Year 2009, 1,496 employees were in a use or lose situation, forfeiting a total of 38,103.75 hours. When compared to the total number of annual leave hours accrued by all benefited employees in 2009, 1.5 percent of the hours accrued were lost.

Agencies pay into a termination pool in order to fund annual leave payouts. However, they do so on a pay-as-you-go basis. The full amount of accrued liability itself is not covered. Agencies pay into the termination pool only enough to cover current year payouts.

Sick Leave

Employees earn a flat rate of four hours per pay period amounting to 104 hours or 10.4 days annually regardless of years of service. Sick leave has no cap on accrual. Sick leave can be traded for another leave account called "converted sick leave." The converted sick leave account provides incentives to accumulate sick leave. The maximum annual conversion is 40 hours with a total maximum account accrual of 320 hours. (This issue will be explained in further detail later in the report.)

Holiday Leave

Employees are also given ten holidays per year. They are:

- New Year's Day—January 1
- Dr. Martin Luther King Jr. Day—third Monday of January
- Washington and Lincoln Day—third Monday of February
- Memorial Day—last Monday of May
- Independence Day—July 4
- Pioneer Day—July 24
- Labor Day—first Monday of September
- Veterans' Day—November 11
- Thanksgiving Day—fourth Thursday of November
- Christmas Day—December 25
- Any other day designated as a paid holiday by the Governor.

Holiday leave is established in statute (see Utah Code 63G-1-301). Including these days in a PTO program might be justifiable for certain departments with 24/7 staffing requirements (such as the Departments of Corrections or Public Safety). But for the majority of state employees and their departments which work the traditional workweek and are closed for business on holidays, including these days in PTO might lead to more time off than intended. Therefore, our analysis does not include these traditional legal holidays.

Table 1 encapsulates the annual and sick leave time offered.

Table 1

Current Annual and Sick Leave Accrual						
Years of Service	Annual Accrual (Capped at 320 Hours)		Sick Accrual (No Cap)		Totals	
	Hours	Days	Hours	Days	Hours	Days
0-4 Years	104	10.4	104	10.4	208	20.8
5-9 Years	130	13.0	104	10.4	234	23.4
10-19 Years	156	15.6	104	10.4	260	26.0
20+ Years	182	18.2	104	10.4	286	28.6

WHAT IS PAID TIME OFF (PTO)?

Paid Time Off (PTO) is a single compensated absence pool that streamlines traditional annual and sick leave and allows employees to use all leave hours for either vacation or when they are sick. PTO combines annual and sick leave accounts into one account. In some cases, PTO may include holiday leave as well as annual and sick.

For example, with traditional leave policies, an organization might offer employees ten paid holidays, two weeks' vacation, two personal days, and eight sick days. Under PTO, all thirty days (10+10+2+8) are treated as one type of leave available for any former use.

PTO hours are typically earned over time. In the example above, if earned on a bi-weekly payroll basis, (26 pay periods) each pay period an employee would earn 1.15 days of leave.

A change to PTO might offer state employers an opportunity to change the number of days offered, the amount of leave that can be carried-forward from year to year, and the ability to cash-out leave upon separation from employment. Any impact on leave costs would depend upon the mix of PTO benefits offered.

WOULD A SWITCH TO PTO REDUCE ADMINISTRATIVE COMPLEXITY?

State employees, their managers, and their payroll clerks must currently manage at least five different leave types. As noted above, there is annual, sick, and vacation leave. Additionally, employees might receive administrative leave and/or "comp time" (time off in lieu of overtime). State workers must manage these various types of leave, accurately account for accrual and use in each category, and assure that each type is being used appropriately under state policy. Executive Branch employees use a central leave accounting system to accomplish this task.

According to a 2008 study by human resource consultants Aon/Hewitt, Paid Time Off "provides employees with flexibility and control over time off" and "simplifies administration, tracking, and communications" (Sladek, Carol and Kim Slatter, "Exploring Total Time Off", Hewett Associates, 2008). We believe a switch to PTO at the State would decrease administrative complexity and increase efficiency in the long-run.

However, transitioning to PTO may increase complexity in the short-run depending upon how the new PTO system is designed. If current employees are "grandfathered" under the old system or allowed to keep currently accrued leave for purposes currently designated, payroll clerks and managers would have to manage an additional leave type until such time as previous leave types are eliminated.

CAN A SWITCH FROM CURRENT LEAVE POLICIES TO PTO GENERATE COST SAVINGS?

Implementing a PTO program has and is being discussed in several legislative settings. However, no bill has been presented for a fiscal note. True costs or savings determination through the fiscal note process are difficult until the details of a new PTO program are determined.

If the Legislature opts to move to a Paid Time Off program, it may want to consider the following questions:

1. Should current employees be allowed to keep their accumulated sick leave and converted sick leave balances?
2. Should current employees be able to continue accruing Program II converted sick leave until the already scheduled end date of January of 2014?
3. Should PTO be the only option for new employees?
4. Should current employees be allowed to opt in to the PTO program in exchange for an increase in pay?

Those questions notwithstanding, a switch from traditional leave to PTO might free-up resources in two ways: improved productivity and reduced pay-out for accrued compensated absences. An additional benefit may be avoided liability for future compensated absences.

What is the potential for productivity savings/improvements?

State employees currently receive the same bi-weekly pay check regardless of whether they worked all 80 hours in the pay period or took some portion of the time off in annual leave, holiday leave, or sick leave. Productivity, or value-added to the state, differs depending on how much of the pay period the employee was actually at work. Paid Time Off will increase state employee productivity by increasing the number of hours an employee will be at work. The extent of the productivity increase or savings depends on the amount of time an employee currently takes off of work and the number of PTO hours given. For the calculations contained in this section we assume that 130 hours of PTO will replace the current accruals of annual and sick leave. The Legislature may approve a PTO accrual of more or less than this amount.

The average employee receives 142 hours of annual vacation each year. (This number is an average because employees receive varying amounts of annual leave depending on years of service.) On average, employees use 119 hours of annual leave. The usage rate of annual leave is therefore 119 hours / 142 hours or 83.8 percent.

As noted earlier, every state employee receives 104 hours of sick leave regardless of years of service. State employees use 60 hours of sick leave each year on average. The usage rate for sick leave is therefore 60 hours / 104 hours or 58 percent.

In addition to the leave usage calculated above, the following information is necessary to calculate productivity savings:

- Accrual difference in hours between PTO and annual leave: 142 (avg. current accrual) minus 70 (assumed PTO accrual) = 72 hours
- Accrual difference in hours between PTO and sick leave: 104 minus 60 (assumed PTO accrual) = 44 hours
- Average state worker hourly rate: $21.48 an hour
- Number of state workers (benefited, core workforce): 16,555

We calculate the productivity savings of PTO as follows:

*PTO Accrual Difference*Hourly Pay Rate*Number of Employees*Usage Rate*

In this case the productivity savings equals the sum of sick leave productivity savings and annual leave productivity savings, calculated as follows:

*Annual Leave Productivity Savings= 72*$21.48*16,555*83.8%=$21,455,600*

*Sick Leave Productivity Savings= 44*$21.48*16,555*58%=$9,074,900*

or

$21,455,600 +$9,074,900=$30,530,500

If state employees were to receive 130 hours of Paid Time Off instead of the current annual leave and sick leave accruals, the State could expect to realize approximately $30.5 million of additional productivity. A comparably calculated one percent salary increase for the same number of state workers would cost about $7.4 million.

These calculations assume that an employee will perform the same amount of work on the additional work days required under Paid Time Off as on previous work days. It should also be noted that productivity savings represent the increase in work performed, not budgetary savings. Budgetary savings could only be achieved through workforce reductions.

Productivity, as used in this section, denotes the time a state employee engages in state work for which he or she receives compensation. It does not attempt to quantify what the employee accomplishes in that time or the incremental work that could be accomplished had the employee worked harder (i.e. employee effectiveness). The Legislative Auditor points out in, “A Performance Audit of the Working 4 Utah Initiative,” that decreases in employee effectiveness as a result of HR policies can have significant costs to the State (estimated at $15 million for every one percent reduction in effectiveness). Though difficult to quantify, legislators should weigh the benefits of productivity savings with the costs of potential effectiveness decreases resulting from Paid Time Off.

If the Legislature were to replace reduced leave time with an increase in employee salaries, it would have to determine what amount of leave to offer and how much monetary compensation would increase in exchange. As noted earlier, employees currently earn from 104 to 182 hours (depending on service years) of annual and 104 hours of sick leave per year. If a PTO Program granted 130 hours of leave, the salary value difference would range from 3.75 percent to 7.5 percent of annual salary. Using the same assumptions stated earlier (core workforce, average salary, etc.), it would cost approximately $41,000,000 to replace the average leave reduction with increased salaries on a one-for-one basis. Table 2 estimates the cost to replace the value of average lost hours.

Table 2

Cost to Replace Value of Average Lost Hours for State Employees									
Hours Earned Per Pay Period	Annual Hours Accrued	Sick Hours Accrued	Total Annual + Sick	Leave Value @$21.48/hr	Possible PTO Hours	New PTO @$21.48/hr	Difference Current vs PTO	Annual Salary @$21.48/hr	> Required Breakeven
< 5 yr = 4 hr	104	104	208	4,468	130	2,792	(1,675)	44,678	3.75%
5 - 10 yr = 5 hr	130	104	234	5,026	130	2,792	(2,234)	44,678	5.00%
10 - 20 yr = 6 hr	156	104	260	5,585	130	2,792	(2,792)	44,678	6.25%
> 20 yr = 7 hr	182	104	286	6,143	130	2,792	(3,351)	44,678	7.50%

Number of employees	16,555
Average per hour wage	$21.48
Average hours of annual earned	142
Sick hours earned	104
Breakeven cost/average 142 hours/ employee = 5.6%	

Cost to replace breakeven hours	16,555 x 21.48 x 2080 x 5.6%	$41,420,451

How might PTO impact termination pool costs?

If the Legislature replaces the current sick and annual leave programs with a PTO program that does not allow employees to accumulate unused leave hours, it would avoid the costs of funding future termination pool for employees under the PTO program.

The state has established a termination pool to make any cash payout to a terminating or retiring employee as compensation for accrued annual and sick leave hours. The pool ensures sufficient funds to pay terminating employees without causing a significant and unexpected expense on the agency's budget.

Revenue comes to the termination pool through a rate (a percentage of the employee's salary) charged to the employee's agency. The following rates are currently charged:

Agency Type	Termination Pool Rate
Education	1.00% of salary
General/Other	0.75% of salary
Public Safety	0.00% of salary
Transportation	0.00% of salary

Current rates are likely artificially low because pools have balances that are being drawn down. The statewide average over the past several years is approximately 2 percent. Rates for Public Safety and Transportation are currently set at zero because they have a positive balance. In FY 2009 their rates were 3.50 percent and 1.50 percent respectively. The Division of Finance monitors fund balances and recommends rate adjustments as needed so that the pool breaks even. The Legislature typically accepts the recommendations and includes their impacts (both positive and negative) in appropriations bills for employee compensation.

Additional rates are charged for Other Post Employment Benefits (OPEB, or retiree health and life insurance); however, these benefits were addressed by House Bill 213, 2005 General Session. Employees are no longer accumulating sick leave hours for OPEB specifically.

House Bill 213 changed the way accrued sick leave is paid out to state employees. The following sections highlight the way unused sick and annual leave hours are paid through the termination pool.

Unused Sick Leave Programs: The state provides unused sick leave programs for regular state employees upon termination and retirement. These programs are referred to as "Program I" and "Program II." Program I was used prior to January 1, 2006. After passage of House Bill 213, all leave earned since January 1, 2006 became Program II.

After employees have a sick leave balance over 144 hours, they are eligible to "convert" up to 40 hours of sick leave per year. Converted sick leave becomes similar to annual leave. The maximum converted sick leave under Program I plus Program II is 320 hours. When an employee terminates, any balance in converted sick leave is paid to the employee. However, the ability to convert sick leave hours ends on January 1, 2014.

When an employee retires, he or she receives up to 25 percent of his/her unused accumulated sick leave as a mandatory contribution into a 401(k) account. This applies to all Program I and Program II sick leave and converted sick leave.

The balance of Program I sick leave and converted sick leave is used to provide Other Post Employment Benefits. The balance of remaining Program II sick leave and converted sick leave is placed in a defined contribution plan – health reimbursement arrangement administered by Utah Retirement Systems.

Annual Leave: As stated earlier in this report, employees earn from 4 to 7 hours of annual leave per pay period, with a maximum of 320 hours that may carry forward from one calendar year to another. When an employee terminates or retires, he or she receives a payout of 100 percent of his/her unused accumulated annual leave at her final hourly rate.

Table 3 shows how the various sick and annual leave programs are paid upon termination and retirement. With the exception of Program I sick leave and Program I converted sick leave paid to Other Post Employment Benefits, all other payouts come from the Termination Pool.

Table 3 – Comparison of Leave Payments upon Termination/Retirement

	Program I Sick Leave	**Program I Converted Sick Leave**	**Program II Sick Leave**	**Program II Converted Sick Leave**	**Annual Leave**
When Employee Terminates but Doesn't Retire	No benefits paid	100% paid to employee – Paid out of the Termination Pool	No benefits paid	100% paid to employee – Paid out of the Termination Pool	100% paid to employee – Paid out of the Termination Pool
When Employee Retires	Up to 25% goes to 401(k) – Paid out of Termination Pool. After various deductions through 2011, balance goes to OPEB (health and life insurance)	Up to 25% goes to 401(k) – Paid out of Termination Pool. Balance goes to OPEB (health and life insurance)	Up to 25% goes to 401(k) – Paid out of Termination Pool. Balance is assigned a dollar value and placed in health reimbursement arrangement – Paid out of Termination Pool	Up to 25% goes to 401(k) – Paid out of Termination Pool. Balance is assigned a dollar value and placed in health reimbursement arrangement – Paid out of Termination Pool	100% paid to employee – Paid out of the Termination Pool

Table 4 displays amounts paid out from the Termination Pool for the various sick and annual leave programs since FY 2007.

Table 4 – Termination Pool Payments, FY 2007 – FY 2010				
	FY 2007	**FY 2008**	**FY 2009**	**FY 2010**
Annual Leave and Converted Sick Leave payouts (Program I and II) to employees who terminated but didn't retire	$5,317,800	$5,637,800	$5,821,300	$6,564,300
401(k) payouts to employees who retired (Program I and II)	$2,082,700	$2,353,300	$3,328,700	$3,618,100
Health Reimbursement Arrangement payouts to employees who retired (Program II only)	$456,200	$968,800	$1,765,500	$3,081,000
Total	$7,856,700	$8,959,900	$10,915,500	$13,263,400

Payments from the Termination Pool are growing over time because costs are gradually shifting from Program I's Other Post Employment Benefits to payouts allowed by Program II. Although Program II costs are increasing, they are less than Program I's costs would have been absent House Bill 213. The last actuarial valuation of Program I showed a $9.6 million decrease in the annual required contribution.

Data are not available to separate payouts between Program I and Program II for the first two program types in Table 4, but because of the newness of Program II, it is likely that less than 20 percent of payouts fell under that program in FY 2010. However, health reimbursement arrangements (the third program type in Table 4) are entirely Program II, and costs are increasing.

Over time Program I's annual costs should decrease further. However, as those costs decrease, the state is not setting-aside funds to cover the increasing costs of Program II. As Table 4 shows, these Program II costs are increasing rapidly, as are the liabilities associated with Program II. We recommend the State recognize the increasing liabilities associated with Program II up-front. As Program I costs continue to decline, the State should set-aside a portion of the savings to cover Program II costs.

WHAT LEGAL AND MANAGERIAL QUESTIONS SHOULD BE ANSWERED IF CONSIDERING A SWITCH TO PTO?

This report has examined current leave and sick programs offered state employees and the possibility of implementing a Paid Time-Off Program as their replacement. Developing the comparisons of the two systems raised several questions that should be considered before proceeding with legislation:

- Do state employees have property rights with the current leave and sick programs?
- Were any property rights given with the "tier two program" offered as a substantial substitute for the pre-HB 213 sick leave program?

- As was mentioned above, PTO productivity savings is based on the premise that time off behavior will remain the same if the current leave programs are replaced with PTO. Based on the findings of the Legislative Auditor's Office with their audit of the "Four Tens Work Week" the increased productivity as originally expected did not happen. Applying that information to potential increased productivity with PTO, would potential savings be offset because employees who now defer using sick leave with the anticipation of using the unused time for purchase of post retirement health insurance be disincentivized and use more time off than they currently use, thus negating productivity savings?
- Do future savings outweigh the potential loss of good will with employees?
- Will PTO hamper recruiting and retention?

WHAT ARE SOME POTENTIAL UNINTENDED CONSEQUENCES?

Human behavior will certainly become a factor in what occurs should the state implement a PTO program. The current program motivates employees to save leave time for a "rainy day," should an employee or employee's family member(s) encounter health problems, or for a retirement benefit. The data suggests this is happening. As previously stated, the average employee earns 142 hours of vacation leave annually, but only expends 119 hours each year, for an average annual accrual of 23 hours. Employees also earn 104 hours of sick leave annually, but only expend 60 hours on average for an average yearly savings of 44 hours. The average employee uses 179 hours annually. Employees would be incented to use all PTO hours allotted annually should accrual not be permitted.

It is possible that if the number of leave hours were reduced, some employees may request leave without pay. This unknown may impact agency productivity and it is not known to what extent this may become an issue.

The data that has been secured to this point is general. More specific data on subsets of the workforce may identify additional concerns. For example, gender, age, state agency, and type of job differences may also be issues for further study. Some questions might include:

- Would female employees in their childbearing and rearing years be impacted with substantially less leave available each year?
- As employees age, do they have a need for more leave to deal with health issues either for themselves or their families?
- Would a smaller workforce result in safety issues in agencies such as Child and Family Services, Corrections, or Public Safety?
- Can every agency reduce its workforce given that many jobs require specialized education, training, and possibly licensing or certification?

HOW MIGHT POLICYMAKERS PROCEED?

Policymakers have at least five options on how to move forward on employee leave policies:

1. Do Nothing: Legislators may choose not to make any changes at this time.
2. Prospective Employees Only: State government might retain annual and sick leave for current employees but offer PTO to new hires. Depending upon the mix of salary and benefits - including PTO - such a move might present recruiting challenges. However, over time and through attrition, it would reduce obligations associated with payment of accrued annual and sick leave as well as Program II post retirement benefits.
3. Opt-in Period: Policymakers might allow current employees to willingly transition from annual and sick leave to PTO in exchange for some other form of compensation. Such an approach might begin to reduce leave costs and diminish future obligations, but would likely cost more than it saves. In this case, rational actor theory suggests that only those who receive a net benefit would choose to opt-in.
4. Wholesale Change: The Governor and Legislature could mandate an immediate and thorough change from annual and sick leave to PTO for all existing and future state employees. Such a change would save the most in leave

costs, and therefore allow the most in salary increases. However, given the history of benefits such as Program I & II sick leave, this option may present significant legal and political consequences.

5. Some Combination of the Above: Legislators and the Governor might agree on a mix of changes. For example, the State might convert annual leave and a portion of sick leave to PTO immediately for all employees, allow those employees to keep their leave balances to use in addition to PTO, but end non-Program II leave payouts upon termination (option 4 above). It might continue Program II post retirement benefits equal to 25 percent of accrued sick leave, but offer employees an Opt-In window that would exchange those benefits for salary increases (option 3 above). It might also offer only PTO to new employees (option 2 above).

CONCLUSION

Depending upon the quantity and structure of leave benefits offered with Paid Time Off, a switch to PTO from traditional annual and sick leave likely would result in administrative efficiencies in the long term and could generate budget savings through workforce reductions. Such savings could then be applied to existing employee salaries. However, any switch to PTO would present significant legal and managerial issues, as well as potential unintended consequences. Such issues should be carefully considered in a policy making committee prior to making PTO related budget changes. Regardless of whether the State moves to PTO, it should begin recognizing increased liabilities associated with Program II compensated absences and set-aside resources to cover those liabilities before they happen.