



Will Tetsell, City Auditor
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Date May 24, 2016

Audit Committee of the City of Minneapolis,

Sick and vacation leave are both valuable benefits to the employees of the City of Minneapolis. Traditionally, cities have provided relatively generous leave benefits, which helps compensate employees for other perks that aren't typically offered in the public sector.

The City has to accommodate a variety of different policies for sick and vacation leave for the various bargaining agreements, non-represented employees, appointed employees, and elected officials. Due to the ways that vacation and sick leave have been established and structured over time, the City should communicate leave benefits to employees and ensure all applicable state and federal laws have been considered.

Attached is the City of Minneapolis Internal Audit Department's memorandum on the risks associated with employee separation, provided on the request of the Audit Committee. The attached memorandum details the analysis that we conducted to understand the risks associated with how the City has chosen or agreed to structure the sick and vacation leave programs.

Sincerely,

A handwritten signature in black ink that reads "Will Tetsell". The signature is written in a cursive, flowing style.

Will Tetsell, City Auditor



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Date: May 24, 2016
To: Audit Committee of the City of Minneapolis
Re: Employee Separation Analysis

Background

The Audit Committee gave staff direction at the January 26, 2016, Audit Committee meeting for the Internal Audit Department to conduct an analysis of the risks the City faces with the sick and vacation leave benefits with a focus on employee separation.

The City Ordinance defines Accrued sick leave as sick leave credit earned and not used pursuant to civil service commission rules, a collective bargaining agreement, a compensation plan for appointed personnel or a compensation plan for non-represented personnel. Accrued vacation leave is defined as vacation leave credit earned and not used pursuant to civil service commission rules, a collective bargaining agreement, a compensation plan for appointed personnel or a compensation plan for non-represented personnel. Further, the ordinance defines 'retirement' as employees leaving the employ of the City under one of the following situations:

1. The employees have no less than twenty years of service as computed for retirement purposes, or
2. The employees have reached sixty years of age, or
3. The employees are required to retire earlier because of a disability, or
4. The employees have reached mandatory retirement age.

Vacation and Sick leave are memorialized by 25 labor agreements, civil service commission rules 16 and 17, and the City Ordinance. Each respective document has varying levels of detail on how vacation and sick leave are earned, taken and handled upon separation of employment.

Scope & Approach

The scope of this analysis included the variety of different union represented, non-union represented, appointed employee classifications and the different agreements, policies and practices for dealing with each of these combinations of scenarios.

Internal Audit looked at the risks the City faces when employees separate from the City and how their sick and vacation time are handled, including risks that the City faces in how current practices affect behavior in using sick and vacation time for both current and separating employees.

Leave Benefits and Time Off

The Minnesota League of Cities Human Resources Manual addresses leave benefits and time off, and makes the following note in regards to the matter:

In general, state and federal laws do not mandate any paid leave benefits (with a few exceptions such as military leave). However, once a city offers a paid leave benefit, there are often laws protecting employees' rights to equal access to that benefit. In other words, if a city elects to offer some type of paid leave like vacation or sick leave, there are a number of laws to ensure all employees will receive that benefit, without regard to race, color, national origin, or any other protected status.

In addition, state and federal laws will often dictate that if a city offers paid leave in one type of situation, it must also do so in another. For example, if a city offers paid leave for an employee who breaks his or her leg, it will also have to offer it when an employee has complications during pregnancy requiring her to miss work.

There are some leaves requiring insurance benefits to be offered, such as during military leave and FMLA. It is important to check for compliance with your insurance plans and contracts to permit continuation of benefits during these types of leaves

Vacation Leave

Vacation leave is offered as a benefit because it allows for employees to take breaks from their work, attend to their personal affairs, and an additional benefit is the increased likelihood that any illegal or inappropriate practices will be discovered by the employee who is filling in for the absent employee.

According to the Minnesota League of Cities, State law requires an employer to pay wages earned to any employee who has been discharged. A city's vacation policy, not statute, covers what, if any, unused vacation or PTO leave will be paid to the separating employee. Although state statute does not define wages earned, a 2007 court decision indicated accrued vacation is considered wages earned that does need to be paid to the employee at termination when a city's policies require the payout of unused vacation or PTO leave upon separation. On the other hand, if a city's policies or a union contract explicitly define situations when vacation or PTO will not be paid out (e.g., under dishonorable conditions and or without two weeks' notice) then the city will want to consult with the city attorney to determine whether any vacation or PTO payout will apply.

There are slight variations on how vacation time is accrued, but vacation leave is capped at 50 days; some bargaining agreements allow for the vacation accrual to go above 50 days during the year, but anything over 50 days at the end of the cycle year is lost.

Vacation Leave Options at Termination or Retirement

Vacation leave accruals are paid out in different ways depending on employee group (appointed, non-represented, and represented).

Bargaining Agreement Vacation Leave Pay Out –bargaining unit labor agreements can differ in their language and treatment of vacation leave options upon termination or retirement. Some bargaining agreements allow for employees that are retiring to schedule remaining vacation days or authorize payment for all accrued vacation. If the option of payment is selected, the City may also be required to pay for the potential vacation days that the employee would have earned if they had scheduled vacation (employees accrue vacation days while taking vacation days).

Civil Service Rules - The civil service rules don't include details on what options are available to non-represented and appointed employees upon termination or retirement, rather they provide rules on how employees accrue and use accrued sick and vacation leave.

City Ordinance – The City Ordinance includes details on how accrued sick and vacation balances are paid

out at the end of an employee's term with the City for regularly appointed and non-represented employees of the City and of the City's independent boards and commissions. The ordinance also establishes the health care savings plan, which portions of accrued vacation balances could be paid into. The ordinance further establishes that 50% of non-represented and appointed employees accrued vacation balances are paid in cash and the other 50% is put in the employee's healthcare savings account.

Informal Policies - Internal Audit also learned that there exists an informal and unwritten rule purporting that employees are not to run their vacation out at the end of their employment with the City; however, department heads can approve deviations from this policy.

Vacation Leave Risks

The City faces a variety of risks with vacation leave on or around an employee's separation with the City:

Scenario 1:

The employee is granted permission to use their remaining vacation leave balance at the end of their employment with the City, which maintains the employee's work status as active.

Risks:

- Active employees may be functionally done with their jobs and potentially have access to systems, property, assets, etc. that may not be appropriate or necessary.
- May also keep the department from being able to backfill the position timely.
- This scenario may be perceived as preferential treatment when only certain employees are granted this choice and does not adhere to the MN League of Cities guidance that employees have equal access to this benefit.
- Employees taking scheduled vacation are considered active employees, which make them eligible for fringe benefits such as health and life insurance, PERA contributions, and active employees continue to accrue more sick and vacation time.
- Because the employee is functionally done with their work at the City, any serious injuries or fatalities put the City at risk of the insurance claims being denied and the City being liable for the related expenses.

Scenario 2:

The employee does not inform the City of their intent to separate employment, schedules and takes vacation, and then quits upon their return.

Risks:

- Leaves the City with less time to plan for work transition, make succession decisions, and ensure that the employee and City handle of the employment related affairs appropriately.
- This scenario may also keep the department from being able to backfill the position timely.

Vacation Leave Considerations

The root cause of these vacation leave risks are likely two scenarios. Employees leaving the City don't want half of their accrued vacation balance to be put in their healthcare savings account, or they don't want to pay the higher tax rate on vacation pay outs. Because employees wish to avoid these two situations, the City should consider whether the current vacation stipulations in place are appropriate, or whether the option of how accrued vacation is treated should remain with the employee. Doing so could help the City avoid situations where employees attempt to circumvent the process in order to achieve their desired outcome.

Another benefit of providing employees with choices is that processes can be established to appropriately handle each unique situation, and policies can be established to deter employees from circumventing the current processes. For example, some cities only pay accrued vacation balances out when employees leave

on good standing, which could include the inability to take accrued vacation leave at the time of resignation or within two weeks of their final day of work, whichever is greater.

Beyond the potential for employees having access to systems, property and assets, there is a financial element to employees that are running their accrued vacation out at the end of their City employment. As an example, a non-represented employee with a \$75,000 salary who was on the family health care plan that was allowed to run out their max vacation accrual (50 days) would cost the City almost \$13,000 (over \$250 per day) from health care benefit contributions, PERA contributions, and sick and vacation leave benefits alone.

Sick Leave

Like vacation, many Minnesota cities offer paid sick leave to their regular full-time employees and sometimes pro-rated sick leave to their regular part-time employees. The advantages to the city are similar to those mentioned above with regard to vacation. An additional advantage is employees who are ill and come to work anyway are apt to be contagious to their co-workers and also not very productive.

The rates at which sick leave are earned are consistent at one day per month of service. Certain employee groups are granted a pool of sick leave up front while others earn it over time. There is no limit to the amount of sick leave that a City employee can accrue.

Sick Leave Pay Out

Sick leave accruals are only paid out as a severance benefit when an employee is retiring as defined above, and the employee has no less than 480 hours of accrued sick leave. If this condition is met, 50% of the accrued sick leave hours are converted into cash at a daily rate of pay for the position held by the employee on the day of retirement, the other 50% is unpaid.

Sick Leave Risks

Because sick leave accruals do not have a maximum, and there is a minimum accrual balance required at retirement to get even the 50% severance pay, sick leave is inherently more prone to being abused than vacation leave. The City faces a variety of risks with vacation leave on or around an employee's separation with the City.

Scenario 1:

An employee foresees not being able to accrue the minimum balance required for a severance payment instead begins using sick days as personal days.

Risks:

- The department/division experiences diminished productivity and has less ability to plan work since sick days don't require being scheduled and approved (unless the number of sequential days reaches a level where a doctor's note could be required of the employee.)

Scenario 2:

Employees come in to work sick because they wanted to maintain their accrual levels and not lose the severance pay upon retirement or accrue more sick time to be able to sell some back to the City.

Risks:

- Employees come to work sick and are potentially contagious, take longer to recover and are less productive

Scenario 3:

The employee is granted permission to use their remaining sick leave balance at the end of their employment with the City, which maintains the employee's work status as active.

Risks:

- See scenario 1 within the vacation leave risks section above.

Sick Leave Considerations

Although accrued sick leave is only a monetary benefit if an employee is eligible to retire under the aforementioned guidelines, employees perceive sick leave as a monetary benefit and consider that benefit stripped from them if they're not eligible for the retirement severance and get a 50% cash value, or get nothing at all if they don't meet the eligibility requirements. To prevent employees from running out sick time at the end of their employment at the City, or either abusing or hoarding sick time to avoid losing the perceived monetary benefit, the City could make decisions that entice people to use sick and vacation time for their intended purposes.

Conclusion

In either case of vacation leave or sick leave, the way in which the City has structured the programs has left employees in situations where they may make decisions or devise plans to maximize their perceived benefits, which could lead to the circumvention of controls and established processes. It's these ways in which employees may choose to circumvent practices that expose the City to the most risk. In certain circumstances, the City could choose to establish practices and procedures to provide employees with more options and, in turn, control those outcomes so as to not be exposed to the risks of perceived preferential treatment or having active employees that are functionally not planning on performing their jobs any longer who retain access to systems, data, property and assets that are not always appropriate. In either the case of allowing employees to run out sick or vacation leave balances at the end of their employment with the City, the City is paying for employee's benefits, including healthcare premiums, PERA contributions, life insurance, etc. that wouldn't be incurred if vacation and severance payouts were made instead.