

TO: City Council
FROM: James L. App, City Manager
SUBJECT: S.L.O. Grand Jury Report – Vacation Accrual
DATE: May 1, 2012

NEEDS: For the City Council to consider a response to the Grand Jury's findings regarding vacation accrual.

FACTS:

1. The San Luis Obispo County Grand Jury provided the City a report concerning employee vacation accrual practices February 28, 2012.
2. The Grand Jury report requires a response by May 30, 2012.
3. The Grand Jury's "findings" and "recommendations" are detailed with the City's responses (attached).

ANALYSIS &

CONCLUSION: The Grand Jury properly suggests the City review its vacation accrual policy. The City agrees that it is prudent to occasionally re-evaluate employment policies. Accordingly, the City will review vacation accumulation practices with the City Council and employee associations through the meet and confer (i.e., collective bargaining) process.

However, the Grand Jury mistakenly infers that management is not aware of, addressing, or providing for the costs of accrued vacation. To the contrary, the City regulates the duration of position vacancies to offset (average) vacation balance expense on operating results:

Vacated positions are typically left vacant for a period of at least three months (i.e., 73 work days), which offsets average vacation balance expense (approximately 36 days currently). Typically, more is saved than paid out.

In addition, General Fund reserves are maintained at an amount no less than 15% of operating income (as a matter of Council policy), and in actuality much more (currently, approximately 40% could be made available) for unforeseen and/or extraordinary expenses. Utility Funds, that incur a portion of accumulated vacation costs, maintain reserves as well.

NOTE: Hypothetically, if every employee were terminated simultaneously, payout of vacation balances would be easily covered from reserves.

More importantly, the practice of regulating vacancy duration is an effective tool for reducing operating costs, even during periods of extreme financial retrenchment:

From late 2007 through December 31, 2011, the City experienced significant revenue shortfalls (resulting from an historic nationwide economic recession). Despite extraordinary losses, the 2012 Fiscal Year is projected to close balanced, plus a 40% reserve in the General Fund; Utility Funds maintain positive reserves as well. This was accomplished by incentivizing early retirements and regulating the duration of vacancies.

In summary, while the City Council could earmark a portion of General (and other) Fund(s) reserves to cover the payout of all accumulated vacation simultaneously, it is highly unlikely that a circumstance would arise necessitating such a payout. If the City ever faces the (unlikely) prospect of bankruptcy, position vacancy regulation would be effective in limiting the scope of, or possibly even avoiding, bankruptcy. And, it could be done without overly restricting reserves that might be needed for other extraordinary expenses.

POLICY

REFERENCE: City Fiscal Policy; established vacation accumulation practice.

FISCAL

IMPACT: Continuing the City's current practices has positive bottom line impacts while preserving reserves for other unforeseen expenses. However, there are alternatives including:

- Payout of accumulated leave balances over time.

The cost per one week payout (for all full-time employees) is approximately \$225,000. This expense would have a negative operating impact necessitating offsetting cost reductions or use of reserves.

- Limit the amount of vacation time that may be accumulated.

Limits would require agreement from employee associations, the financial means to cash out amounts that exceed the limit (see financial impact of payouts immediately above), and/or a loss of productivity (when employees take earned vacation time in amounts greater than has been the historical practice).

- Earmark a portion of reserves to fund the simultaneous payout of all accumulated vacation.

Exclusively earmarking a portion of reserves to cover payout of all accumulated vacation is well within the City's current and projected financial capacity, however doing so would limit the City's capacity to respond to other urgent priorities, unforeseen or emergency expenses.

- OPTIONS:
- A. Approve the City's Response to the S.L.O. Grand Jury Regarding Vacation Accrual, and
 - 1. Direct staff to review vacation accumulation practices with employee associations; and
 - 2. Authorize amendment of City vacation accumulation policy consistent with the outcome of A.1. above; and
 - 3. Consider whether to earmark a portion of reserves for simultaneous payout of accumulated vacation when reviewing the June 2012 update of the Financial Forecast and Recovery Priorities.

 - B. Amend, Modify or Reject the Option Above.

Attachment: City Response to SLO Grand Jury Vacation Accrual Report.

April 2012

Response to March 2012 Grand Jury Report

Pay Me Now or Pay Me Later
City Employee Vacation and Sick Leave Accumulation Pay

Responder: James L. App, City Manager

FINDINGS:

- We agree with the findings numbered: 2, 6 & 10
- We disagree wholly or partially with the findings numbers: 1, 3, 4 & 5

(See attached statement of explanation in response to findings)

RECOMMENDATIONS:

- Recommendations numbered 9 & 10 have been implemented.
- Recommendations numbered 1, 2, & 3 have not yet been implemented, but will be implemented in the future.
- Recommendation number 5 requires further analysis.
- Recommendation number 4 will not be implemented because it is not warranted or is not reasonable.

(See attached statement of explanation in response to recommendations)

Date: _____ Signed: _____

Number of pages attached: 6

ATTACHMENT
Response to March 1, 2012 Grand Jury Report

Pay Me Now or Pay Me Later
City Employee Vacation and Sick Leave Accumulation Pay

Thank you for the opportunity to comment on the above referenced Grand Jury report.

The City of Paso Robles' employee vacation accrual process (i.e., allowing unlimited accumulation) has been consistently practiced for over twenty years. As an established and long-standing practice consistently applied to all employees, it carries the force and effect of policy. Therefore, the City is not in gross violation of its policies, rather the printed vacation policy is obsolete (i.e., inconsistent with established practice). More importantly, accumulated vacation does not constitute an unfunded liability (as explained below).

Notwithstanding the above, the City intends to review its vacation accumulation practices with the City Council and employee associations, and carry out the outcomes from the meet and confer (collective bargaining) process. Additionally, the City will consider whether to implement alternative accounting practices (i.e. earmarking a portion of budget reserves for future payout of accumulated vacation) in conjunction with review of the City's June 2012 update of the Financial Forecast and Recovery priorities.

FINDINGS

Finding No. 1: There is substantial unused accumulated vacation time in all jurisdictions in San Luis Obispo County.

Response: *Partially disagree. "Substantial" is not defined. However, what is evident is that accumulation of vacation is not an uncommon employee benefit and can be an effective tool to promote employee productivity and security, as well as manage operating costs.*

Finding No. 2: With the exception of the City of Grover Beach and Arroyo Grande, all jurisdictions in San Luis Obispo County allow unlimited accrual of sick leave. All jurisdictions but one, however, have a policy allowing the buy

back or payoff of accumulated sick leave either annually or upon leaving city employment.

Response: Agree - assuming the statement for other cities is accurate. The City of Paso Robles does not buy back or payout accumulated sick leave at time of employee separation.

Finding No. 3: The City of Paso Robles, with only 165 employees, has more than 47,000 hours of accumulated vacation on its books and an enormous unfunded liability of \$1,646,575.

Response: Partially disagree. At the time of reporting statistics to the Grand Jury these employee and vacation accrual numbers were correct. The City currently has 155 fulltime employees. Regardless, the City disagrees – as will be explained below, the amounts do not constitute an unfunded liability.

Finding No. 4: The City of Paso Robles has a policy stating that no employee can exceed one-and-one-half times their annual accumulation or they will lose their vacation time.

Response: Partially disagree. The City's Personnel Rules and Regulations that were adopted in 1989 contain a policy commonly referred to as "use it or lose it" language. However, subsequent to adoption of these personnel regulations, Federal Labor Laws nullified "use it or lose it" policies. Hence, the City modified its practices over twenty years ago to allow unlimited accumulation. Consequently, the 1989 policy is obsolete (i.e., inconsistent with established practice).

Finding No. 5: The City of Paso Robles is in gross violation of its own policies governing accumulated vacation time; 40% of City employees exceed the stated policy.

Response: Disagree. Unlimited accumulation has been the established practice of the City for over twenty years. The 1989 policy is obsolete (i.e., inconsistent with established practice).

Finding No. 6: The City of Paso Robles has not updated its personnel rules and regulations since 1989.

Response: Agree.

Finding No. 10: Most jurisdictions do not update their personnel rules and regulations after MOUs are developed with each bargaining unit. All personnel rules are incorporated into any new MOUs, but personnel rules are not always updated accordingly.

Response: Agree. However, each MOU contains language which makes it clear that where a conflict may arise between the MOU and Personnel Rules and Regulations language – the MOU language prevails.

RECOMMENDATIONS

Rec. No. 1: All jurisdictions should review their accumulated vacation time and implement steps to address future accumulation and payment of vacation time.

Response: The Grand Jury properly suggests the City review its vacation accrual policy. Accordingly, the City will review vacation accrual practices with the City Council and employee associations through the meet and confer (i.e., collective bargaining) process.

Rec. No. 2: All jurisdictions that do not update their personnel rules after implementing new Memorandums of Understanding should update their personnel rules to reflect current practices.

Response: The City concurs that the personnel rules and regulations should be a dynamic document that can be revisited and modified as needed.

Rec. No. 3: The City of Paso Robles should review and update its Personnel Rules and Regulations.

Response: The Grand Jury properly suggests the City review and update its Personnel Rules and Regulations. The City will consider a comprehensive update when community priorities and resources allow.

Rec. No. 4: The City of Paso Robles should take immediate steps to stop additional vacation accumulation in violation of its own policies.

Response: Unlimited accumulation has been the established practice of the City for over twenty years. The City does not have legal grounds to unilaterally cap or eliminate accrual of vacation time. However, as stated in the response to recommendation no. 1, the City intends to review and possibly revisit vacation accrual practices, exploring them with the City Council and employee associations through the meet and confer process.

Rec. No. 5: In order to reduce its unfunded liability, the City of Paso Robles should consider a multi-year program to pay off accumulated vacation time.

Response: The inference that the costs of accrued vacation are unfunded is mistaken. To the contrary, the City regulates the duration of position vacancies to offset (average) staff vacation accrued balance expense on operating costs.

For example: Vacated positions are typically left vacant for a period of at least three months (i.e., 73 work days), which offsets average vacation balance expense (approximately 36 days currently). Typically, more is saved than paid out.

In addition, General Fund reserves are maintained at an amount no less than 15% of operating income (as a matter of Council policy), and in actuality much more (currently, approximately 40% could be made available) for unforeseen and/or extraordinary expenses. Additionally, Utility Funds retain sufficient reserves to cover the costs of accumulated vacation for employees of those funds. Hypothetically, if every employee position were eliminated simultaneously, payout of accrued vacation balances would be more than adequately covered from reserves.

Further, the practice of regulating vacancy duration remains an effective tool for limiting, even reducing, operating costs, even during periods of extreme financial retrenchment.

For example: From late 2007 through December 31, 2011, the City experienced significant revenue shortfalls (resulting from an historic nationwide economic recession). Despite extraordinary losses, the 2012 Fiscal Year is projected to close balanced, plus a 40% reserve in the General Fund; Utility Funds have positive reserves adequate to fund their share of accumulated vacation as well. This was accomplished by incentivizing early retirements and regulating the duration of resulting vacancies.

All that said, the City acknowledges that in revisiting its vacation accrual practices as noted in response no. 1, the City will consider whether to implement alternative accounting practices (i.e. earmarking a portion of budget reserves for future payout of accumulated vacation) in conjunction with the City's June 2012 update of the Financial Forecast and Recovery priorities.

Rec. No. 9: All jurisdictions in the County should constantly monitor their accumulated sick leave, vacation and compensatory time to ensure that they do not incur further unfunded liabilities.

Response: The City currently tracks accumulated sick leave, vacation and compensatory time balances for all employees. The City's annual audited financial statements include reporting of the value of accumulated vacation, as well as the City's practice of funding these future obligations with future resources (as described in response to recommendation no. 5 above).

While the City Council could earmark a portion of General (and other) Fund(s) reserves to cover the payout of all accumulated vacation simultaneously, it is highly unlikely that a circumstance would arise necessitating such a payout. If the City ever faces the (unlikely) prospect of bankruptcy, position vacancy regulation would be effective in limiting the scope of, or possibly even avoiding, bankruptcy. And, it could be done without overly restricting reserves that might be needed for other extraordinary expenses.

Rec. No. 10: All jurisdictions in the County should report annually to their citizens on the status of vacation and sick leave accumulations, and compare them

with the prior year to demonstrate how they are addressing the unfunded liability issue.

Response:

The City currently posts on its website the last nine (9) years of Comprehensive Annual Financial Reports (CAFRs) wherein the value of annual vacation leave accruals are provided. Citizens can readily access these posted reports and compare changes in accrual balances from year to year.