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REVISED

The Honorable Mark Hutton, Chairperson
House Committee on Commerce, Labor and Economic Development
Statehouse, Room 521-E
Topeka, Kansas 66612

Dear Representative Hutton:

SUBJECT: Revised Fiscal Note for HB 2426 by House Committee on Appropriations

In accordance with KSA 75-3715a, the following revised fiscal note concerning HB 2426 is respectfully submitted to your committee.

Under current law, KPERS members who joined the system or were in their year of waiting on July 1, 1993 can use the higher of two final average salary calculations:

1. The average of the three highest years of annual salary; or

2. The average of the four highest years of annual salary including pay for longevity, holiday leave, compensatory time, and payouts for sick, vacation and annual leave.

HB 2426 would establish limits on accrual of leave and use of leave in calculating final average salary benefits. The bill establishes a hard cap of 240 hours on the amount of vacation time that can be accrued by any employee of a participating employer. Members above the 240-hour cap on July 1, 2015, would be able to use their accrued vacation leave, but could not accumulate any additional vacation leave if the balance remains above 240 hours. HB 2426 also caps the accrual of sick time for use in a member's final average salary calculation at the amount accrued on July 1, 2015. Members could accumulate additional sick time, but the amount accrued after July 1, 2015, could not be counted as compensation for purposes of calculating final average salary. The bill would limit the use of sick, vacation and annual leave for purposes of calculating final average salary to only those that were earned within the last four years prior to retirement.

HB 2426 would limit the pay rate that could be used in determining the value of accrued leave. Members would be paid for the accrued vacation and sick leave at their current pay rate in accordance with the employer's policies. However, for purposes of valuing the vacation and sick leave used in calculating final average pay, the member's pay rate as of July 1, 2015, would be used.

By limiting the use and value of vacation and sick leave and other add-on pay, KPERS indicates that HB 2426 would be expected to reduce benefits for some pre-1993 members, and therefore, could reduce KPERS's liabilities. However, KPERS does not have any data regarding members' existing vacation and sick leave balances or the point at which they were earned. As a result, KPERS indicates that it is not possible to project the actuarial impact of HB 2426.

However, KPERS' consulting actuary did conduct an actuarial cost study on the impact of eliminating the use of vacation and sick leave payouts in final average salary calculations for pre-1993 members. Because HB 2426 would reduce, but not eliminate, the use of accrued leave, the cost study would overstate the actuarial impact of the bill. Additionally, the study uses data that is more than one year old. However, the cost study can help define the upper limit of any potential savings that may be realized from HB 2426. If the use of vacation and sick leave were eliminated, the unfunded actuarial liability (UAL) of KPERS could be reduced by a maximum of $49.0 million from all funding sources. It is estimated that this would result in approximately $29.8 million in savings from the State General Fund and reductions of employer contribution rates of 0.18 percent for the State Group, 0.04 percent for the School Group, and 0.07 percent for the Local Group. However, only the Local Group would experience a reduction in employer contributions. The estimated employer contribution savings would not be realized because the current State/School Group statutory employer contribution rate is below the actuarial required contribution rate. Local Group savings could total approximately $1.2 million in FY 2017. The cost study savings reflects lower employer contributions required to fund benefits for pre-1993 members. However, HB 2426 would not be expected to result in savings of the amount projected by the cost study. Using figures from the system valuation of December 31, 2013, the cost study indicated that the number of KPERS members hired before July 1, 1993 were 5,237 from the State Group; 14,192 from the School Group; and 5,274 from the Local Group.

KPERS indicates that no processes or systems are currently in place to capture or receive data regarding leave balances and pay rates for more than 20,000 pre-1993 KPERS members as of July 1, 2015, and to then apply the data in enforcing the limits in HB 2426 at any point in the future when the member retires. If add-ons, including vacation and sick leave, could only be included in final average salary calculations if earned in the final four years before retirement, significant additional administrative resources would be required. Modifications to KPERS' information system would be needed to implement HB 2426, but the agency would need to conduct further analysis to project costs associated with the modifications.

The Department of Administration notes that implementing the 240-hour hard cap of vacation leave would require additional costs to make programming changes to the State Human Resource and Payroll System (SHARP). While, the precise expenditure amount is unknown it is assumed that it would be paid from existing resources. The limitation on the amount of sick leave that can be used as a payout would result in savings for state agencies in future years as fewer sick leave hours would be eligible for payouts than the number of sick leave hours otherwise eligible under current law.

According to the Department of Administration, the bill could result in some employees retiring prior to the change to final average salary calculations. However, because individual retirement decisions can differ, it is difficult to predict how many employees would retire. If the number of employees who choose to retire as a result of HB 2426 is high, it is possible that the resources in the State Leave Payment Reserve Fund would be insufficient to cover all of the leave payouts. If this occurs, individual agencies would be required to make up the difference from other funding sources. Again, the precise number of pre-1993 members who would retire because of the bill is difficult to predict. According to budget system information, approximately $11.2 million is estimated to be available in the State Leave Payment Reserve Fund.

Depending on the employees who chose to retire prior to the changes proposed by this bill, the Department of Administration may also incur additional costs as a result of hiring new employees to replace the departing employees. However, if the employees who retire due to this legislation are not required to be replaced, or can be replaced by employees making less than the retiring employees, the Department could realize savings through staffing efficiencies.

The Department of Education indicates that since very few school district employees accumulate vacation or annual leave of more than 240 hours, the provisions of the bill capping or limiting leave time would not have a large fiscal effect on school finances.

The Kansas Department of Transportation (KDOT) indicates that there are 175 employees who have sufficient sick leave balances to use toward their KPERS benefit calculation under current law. If all employees chose to retire prior to the effective date of the new final average salary provision, there would be a fiscal effect from the payout for the accumulated sick leave. However, KDOT would not incur additional expenses from the payouts if the total number of statewide employees who retire does not exceed the resources of the State Leave Payment Reserve Fund.

The Office of Judicial Administration states that the bill could have an effect on Judicial Branch expenditures. It is possible that many long-term, experienced employees who are eligible for retirement could choose to retire before July 1, 2015. While there may be cost savings from turnover and from new hires replacing experienced employees who likely earn higher salaries, there could also be expenses related to processing retirements and hiring and training the new employees. If the loss of experienced employees is high, it may require the courts to pay overtime and temporary hours to ensure cases and documents are processed timely. The 240-hour cap on vacation would not have a fiscal effect. The Judicial Branch, like other agencies, enforces the current 240-hour limit on vacation time accrual.

According to Legislative Administrative Services, legislative agencies are currently exempt from limits on the amount of vacation leave accrued because of the irregular and extended hours staff must work when the Legislature is in session. Employees are able to accrue hours of compensatory time instead of being provided additional pay for overtime. Employees must use their compensatory time first before using annual leave time when seeking time off from work. Passage of HB 2426 could require legislative agencies to discontinue this practice.

Legislative agencies would be required to pay for leave over the 240-hour cap; however, Legislative Administrative Services estimates that there would not be sufficient resources in current legislative agency budgets to absorb the payout of leave overages. Additionally, legislative agencies could need to change to a compensation model that includes the payment of overtime hours.

The previous fiscal note did not contain information from the Department of Administration, Kansas Department of Transportation and Judiciary. Any fiscal effect associated with HB 2426 is not reflected in *The FY 2016 Governor's Budget Report*.

Sincerely,

Shawn Sullivan,
Director of the Budget

cc: Faith Loretto, KPERS
Colleen Becker, DofA
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Ben Cleeves, KDOT
Mary Rinehart, Judiciary
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