

March 11, 2016

The Honorable Ron Ryckman, Jr., Chairperson
House Committee on Appropriations
Statehouse, Room 111-N
Topeka, Kansas 66612

Dear Representative Ryckman:

SUBJECT: Fiscal Note for HB 2725 by House Committee on Appropriations

In accordance with KSA 75-3715a, the following fiscal note concerning HB 2725 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 2725 would establish limits on accrual of leave and use of leave in calculating final average salary benefits. The bill would establish a 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, 2016, would be able to use their accrued vacation leave, but could not accumulate any additional vacation leave if the balance remains above 240 hours.

The accrual of sick time for use in a member's final average salary calculation would be capped at the amount accrued on July 1, 2016. Members could accumulate additional sick time, but the amount accrued after July 1, 2016, 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. In this case, compensation would include any payment for accumulated sick leave, vacation or annual leave paid to the member at the salary rate as of July 1, 2016.

The bill would also limit the amount of sick leave that could be used as a payout at the time an employee retires. Under current law, each employee who retires with 100 days (or 800 hours) or more of sick leave is entitled to compensation for some portion of the sick leave provided the employee meets certain length of service requirements. HB 2725 would allow

compensation only if the employee has accumulated 100 days (800 hours) or more of sick leave as of July 1, 2016.

Each participating employer would be required to report to KPERS the amount of vacation leave and sick leave each member has accumulated and the member's rate of compensation as of July 1, 2016. HB 2725 would not apply to the Kansas Police and Fireman's Retirement System.

Any payments made to any KPERS member on or after July 1, 2016, under a 409A or 457(f) plan would be excluded from being considered as compensation for purposes of calculating a members' final average salary. These plans are contractual agreements between an employer and individual employee. This prohibition would not apply to the more common 457(b) deferred compensation plans offered by the state and many other public employers.

By limiting the use and value of vacation and sick leave and other add-on pay, KPERS indicates that HB 2725 would be expected to reduce benefits for some pre-1993 members, and therefore, could reduce KPERS' 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 2725. KPERS notes that the current laws that allow for the use of a four-year final average salary by pre-1993 members are included in the actuarial assumptions. This benefit provision, like the rest of the retirement system, is designed to be pre-funded. Excluding compensation from 457(f) plans is expected to have a negligible fiscal effect because of their limited use.

KPERS' consulting actuary did conduct an actuarial cost study on the effect of eliminating the use of vacation and sick leave payouts in final average salary calculations for pre-1993 members. Because HB 2725 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. If the use of vacation and sick leave were eliminated, the unfunded actuarial liability (UAL) of KPERS could be reduced by a maximum of \$52.0 million from all funding sources. It is estimated that this would result in approximately \$19.7 million in savings from the State General Fund. Reduction in the UAL would result in reductions of employer contribution rates of 0.19 percent for the State Group, 0.05 percent for the School Group, and 0.10 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. The savings for Local Group participating employers is unknown at this time. The cost study savings reflects lower employer contributions required to fund benefits for pre-1993 members. However, HB 2725 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, 2014, the cost study indicated that the number of KPERS members hired before July 1, 1993 were 4,708 from the State Group; 12,617 from the School Group; and 4,751 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 2725 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 2725, 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 for programming changes to the State Human Resource and Payroll System (SHARP). While the cost 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.

Department of Administration further notes that HB 2725 could result in some employees retiring prior to the changes to the final average salary calculation on the effective date of the bill. 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 2725 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.

Depending on the number of 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 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, 2016. 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 Office notes that the bill could incentivize employees to use more sick time since it would no longer be included in the calculation of the employee's compensation for retirement. 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

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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 2725 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 or increased salaries. This would likely affect future budget requests.

Legislative Administrative Services indicates that there are approximately 20 pre-1993 employees within the legislative agencies. In addition to the potential sizeable fiscal effect of leave payouts, Legislative agencies have noted concern that if all employees retired by June 30, 2016, there would be a loss of key employees and institutional knowledge that would be difficult to replace with new hires. Any fiscal effect associated with HB 2725 is not reflected in *The FY 2016 Governor's Budget Report*.

Sincerely,



Shawn Sullivan,
Director of the Budget

cc: Faith Loretto, KPERS
Colleen Becker, Department of Administration
Dale Dennis, Education
Kelly Oliver, Board of Regents
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