

AUDIT REPORT –
SEVERANCE
PAYMENTS

*Final Report-
October 24, 2012
from the New Castle
County Auditor's
Office*

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Audit Report – Severance Payments

To: Valencia Beaty, Chief Human Resources Officer

Overview

New Castle County (NCCO), upon an employee's retirement or other such termination from the County, makes "severance"¹ payments for the employee's unused vacation, sick, and other leave such as compensatory time or special event time. For Fiscal Year 2011, the total gross amount of these payments was \$1,691,400 for 92 County employees. (This amount does not include the accrued FICA and Medicare amounts).

Vacation

County Code Section 26.03.1404D – "Vacation" states "Employees falling under the scope of this Section who qualify for vacation on the vesting date and are terminated from the payroll of the County before taking vacation shall receive vacation allowance at the time of termination in lieu of vacation time off."

The relevant Code Sections for determining the amount of vacation leave to which a County employee is entitled upon severance from the County are as follows. Please note that, if language in a union contract is different than that in the Code, the language in the union contract prevails. In such situations, we indicate the differences between the union contract and the Code.

- County employees earn vacation leave depending on their length of service with the County, in months and in years. Also, vacation for a calendar year is earned during the prior calendar year.
 - County Code Section 26.03.1404B states "... any employee placed on the payroll of the County on the first workday of any given month shall be considered to have a full month's service in that month." (Please note that the employee must complete that full month.)
 - Section 26.03.1404A states "In all cases, service requirements for vacation are based on service accumulated as of December 31 of the year prior to receiving vacation, except that any employee attaining his or her fifth, tenth, or fifteenth service anniversary and each service anniversary in excess of fifteen (15) years shall be eligible for the additional increment in vacation days during the year in which he or she attains such service."

¹ In a legal context, the term "severance payments" typically denotes payments made to employees who are laid off. New Castle County uses the term to denote payments to terminated employees of their unused vacation, sick, and other leave.

- Section 26.03.1404C provides the vacation leave accrual schedule. “For one (1) or more years of service, vacation leave shall accrue according to the following schedule:

Years of Service	Days of Vacation
1 through 4	10
5 through 9	15
10 through 14	20
15	25
15+	25+ ²

- Accumulated vacation leave, going into a new calendar year, cannot exceed a maximum number of days. For union employees, this amount is either 30 or 50 depending on union affiliation.³ For non-union classified or unclassified employees, this amount is 50 days. County Code Section 26.03.1404G states “... by approval of the general manager and Chief Human Resources Officer (CHRO), a maximum of fifty (50) days of vacation may be accumulated and carried over, provided at least two (2) weeks of vacation is taken in each vacation year.” Union contracts do not require approval of the general manager and CHRO unless the employee wishes to carry over more than 50 days.

All unused vacation leave and accrued vacation is paid upon leaving County service.

Sick Time

The relevant Code Sections for determining the amount of sick leave to which a County employee is entitled upon severance from the County are as follows:

- County Code Section 26.03.1405 – “Sick Leave” states “... an employee shall be credited with one (1) day of sick leave for each completed month of service. Accumulation of sick leave is unlimited.” Thus, County employees accrue one day of sick leave for each completed month of service and the accumulation of these days is unlimited.
- County Code Sections 26.03.1405 A and B deal with the vesting of accumulated unused sick leave. This severance payment is for a maximum of 20 days for voluntary termination and a maximum of 100 days for retirement or involuntary separation (e.g., layoffs and death). For employees hired on or before June 30, 1977, payment is based on one day paid for each day accrued. For employees hired on or after July 1, 1977, payment is based on one day paid for each two days accrued.

² An additional day of vacation for each successive year of accumulated service is awarded in the following year to employees, other than deputy sheriffs, who have completed more than fifteen (15) years of accumulated service with the County.”

³ Certain unions allow a maximum carryover of 30 days if the employee elects to take less than two weeks vacation each year, and a maximum carryover of 31-50 days if the employee elects to take at least two weeks of vacation each year.

County's Accrued Liability for Severance Payments

Footnote #8 in the County's June 30, 2011 CAFR (Comprehensive Annual Financial Report) states "The County accrues a liability for vacation, sick, and other compensated leave as the leave is earned by the employees to the extent it is probable that the County will compensate the employees for the leave through paid time off or some other means, such as cash payments at termination or retirement."

Footnote #8 also states "As of June 30, 2011, total accumulated vacation leave for governmental fund types was \$8,645,590 (including accrued FICA and Medicare), total vested sick leave was \$7,083,622 (including accrued FICA and Medicare), and other total compensated leave was \$557,893 (including accrued FICA and Medicare). These amounts total \$16,287,105 and are reported in the Government-wide financial statements. At June 30, 2011, accumulated vacation, sick, and other compensated leave for Proprietary Funds, in the amount of \$1,966,299, has been included in accrued expenses. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements."

Audit Objectives

The County Auditor's Office performed an audit of the internal controls over the calculation of severance payments made to employees during Fiscal Year 2011.

The objectives of this audit were as follows:

- Determine whether severance payments have been calculated correctly for the individuals selected.
- Evaluate compliance with the vacation and sick time policies in the calculation of the severance payments.
- Determine if Personnel Policy 3.20, "Agreement to Retire in FY 2011", was followed for the calculation of severance payments.
- Determine whether the time and attendance records for the selected employees agree with the PeopleSoft records used to calculate the severance payments.
- Determine whether the Compensated Leave liability and accompanying footnote contained in the Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2011 appear reasonable.⁴
- Compare the severance package from New Castle County Government to packages offered by other local governments in the U.S., as well as businesses in New Castle County.
- Offer suggestions to the New Castle County Administration on areas where they could reduce their costs for this benefit.

⁴ A separate memorandum will be issued to the Finance Department on this aspect of the audit.

Scope

We conducted our audit in accordance with standards promulgated by the Institute of Internal Auditors and the United States General Accounting Office. Our audit testing encompassed a sample of severance payments made during Fiscal Year 2011 (July 1, 2010 to May 31, 2011).

Methodology

Our audit encompassed testing of the following, for each employee tested:

- Recalculated years of service used to determine vacation accrual based on date of hire and termination date, and agreed to amount used in severance calculation.
- Recalculated vacation hours balance according to County policy and/or Union contract and agreed to amount used in severance payment calculation.
- Recalculated sick time hours balance according to County policy and/or Union contract and agreed to amount used in severance payment calculation.
- Recalculated the total number of hours used in determining severance payment.
- Ensured the hourly rate used to calculate the payment amount agreed with the hourly rate per PeopleSoft.
- Recalculated the gross payment amount.
- Ensured that all signoffs on the “Request for Severance Pay” form were obtained and were at the correct level of authority.

We also:

- For selected employees, compared the payroll processor’s time and attendance records to PeopleSoft.
- Analyzed the accuracy and thoroughness of Footnote #8 in the 6/30/11 CAFR.⁵
- Compared the County’s severance package to packages offered by other local governments, as well as local businesses in New Castle County Delaware.

Professional auditing standards require that we plan and perform the audit to obtain reasonable assurance whether internal controls are adequate in all material respects. Our audit of internal control included obtaining an understanding of the internal controls in place for calculating the Severance Payments, testing the operating effectiveness of the controls, and performing such other procedures as we considered necessary in the circumstances.

Our evaluation of internal control may reveal three categories of internal control deficiencies. The first two categories are of a much greater magnitude than the third category.

⁵ See Footnote 4.

- A Material Weakness is a matter that, in our judgment, could adversely affect the County's ability to accomplish its major objectives regarding severance payments.
- A Significant Deficiency is a control exception that is of a lesser magnitude than a material weakness; however, it could potentially have an adverse impact upon the County's ability to accomplish its major objectives regarding future severance payments and, therefore, warrants management's attention.
- Other Reportable Items are opportunities for improvements in the system of internal control over severance payments.

In general, our testing involves audit sampling. We evaluate the results of the tests and use professional judgment, based on the number of exceptions and/or the materiality of such exceptions, whether to include exceptions in the audit report and, if so, in which category to include them. In some cases, we perform additional testing to help us obtain additional audit evidence in making such evaluation and determination.

Because the scope of an audit does not allow us to examine every single function and transaction performed by an area, an audit would not necessarily disclose all matters that might be material weaknesses, significant deficiencies, or other reportable items.

Opinion

In our opinion, adequate internal controls existed over the processing of severance payments for Fiscal Year 2011. We do have one comment in the "Other Reportable Item" section of this report. We also have two comments regarding policy in the "General Comments" section of this report.

Recognition of Participation and Cooperation

We would like to thank the Acting Chief Financial Officer and the Chief Human Resources Officer, and their staffs, in providing cooperation during the course of the audit. We find your staffs to be very conscientious in the performance of their responsibilities.

Response

We issued the final draft report to the Chief Human Resources Officer on September 4, 2012, asking for a response within 30 days stating the actions that would be taken to address the recommendations in the report. Since we never received a response, we are issuing the report without a response.

cc: Paul Clark, County Executive
Gregg Wilson, Acting Chief Administrative Officer, County Attorney

Vincent Meconi, Deputy Chief Administrative Officer
Edward Milowicki, Acting Chief Financial Officer
Helen McKinley, Human Resources Administrator
Susan Vazquez, Accounting and Fiscal Manager
New Castle County Council Members
New Castle County Audit Committee Members

General Comments

1. Severance Payment Policy

Comment

In 2006, the Task Force for the Financial Future of New Castle County (NCCO) Government engaged a consulting firm (Kennedy & Rand) to perform an evaluation of NCCO's salary and benefits compensation package relative to those of other municipalities in the surrounding region. Kennedy & Rand's final report was issued in January 15, 2007. The report stated, with regard to paid leave (vacation, sick leave, holidays, personal leave): "... in the first few years of employment, New Castle County employees are provided paid leave that in the aggregate is somewhat less generous than leave provided by the other employers surveyed. In the middle years of a New Castle County employee's career, however, ... New Castle is at or near the top in terms of the paid leave an employee accrues ... In the later years, ... paid leave accruals for New Castle County employees are markedly more generous than in any of the other jurisdictions surveyed. In those years in the other jurisdictions, accruals of paid leave tend to grow moderately if at all ... Virtually all of the growth in paid leave provided New Castle County employees relative to other jurisdictions is attributable to the County's unusual policy of allowing an employee to accrue an additional day of vacation for each year of service after fifteen years of service."

Please note that the consultant's study only analyzed the amount of paid leave an employee is entitled to on an annual basis. It did not evaluate the amount of leave the employee is entitled to be compensated for upon termination.

NCCO has a large liability as a result of accrued vacation, sick, and other leave time, and is thus paying out a high dollar amount of severance payments each year (\$1,633,909, \$1,691,400, and \$2,085,387 in FY '10, '11, and '12 respectively). To compare New Castle County's severance package to those packages offered by other local governments across the U.S., we sent a survey to the members of the ALGA (Association of Local Government Auditors) asking questions about their policies for accrued vacation and sick time. This survey showed that the County's severance package appears to be one of the most robust packages offered for full-time employees.

Our survey responses from 18 other local governments revealed some ideas that the County Administration and County Council may want to consider:

- Five municipalities only pay for unused sick time upon retirement/death and/or achieving a minimum number of years of service. Thus, if the employee leaves the municipality for a reason other than retirement/death or achieving a minimum number of years of service, he/she is not eligible to receive any compensation for unused sick time. For one of the municipalities that pays for unused sick time only upon achieving a certain minimum number of years of service, the percentage of unused sick time the employee receives is dependent upon how many years he/she has at or above the minimum.

- Three municipalities do not pay for unused sick time at all.
- Two municipalities compensate for unused sick leave at a standard rate for all retirees. Management should consider this as, currently, employees are being paid at the rate they are earning when they terminate service with the County – not the rates they were earning when they accrued the time. (It should be noted, though, that the majority of the respondents indicated that their governments pay the rate the employee is earning when he/she terminates employment.)
- For several municipalities, the maximum number of unused sick days an employee is compensated for is less than the maximum for NCCO. NCCO will pay a maximum of 100 workdays (either 700 or 800 hours). For employees hired after June 30, 1977, the calculation of the maximum is based on one day paid for every two days accrued.
- About half of the respondents indicated that the maximum number of unused vacation days for which an employee is compensated is less than the maximum for NCCO.
- Some municipalities, instead of distinguishing between vacation and sick leave, combine these days into one pool of personal leave hours. The rationale for this is that it allows employees to manage their own leave and not have to “feign sickness” in order to play golf on a work day, for instance. In addition, it also takes supervisors out of the role of having to police their staff’s use of sick leave.

Recommendation

As the County Administration and County Council are looking for ways to rein in future expenses, we suggest that the Administration analyze NCCO’s severance payment policies relative to that of other local governments and consider making changes for new employees.

Management’s Response

Management did not provide a response to the recommendation.

2. *Calculation of Vacation Carryover and Accrued Vacation.*

Comment

Although the maximum number of hours an employee is entitled to carry over from year to year is generally either 350 (35-hour week) or 400 (40-hour week), this number of hours is sometimes “expanded” when an employee terminates employment with the County.

An employee, upon terminating employment with the County, is compensated for the following:

- Vacation Balance:
 - a. The vacation hours he/she carried over into the current year from the previous year.

- b. The vacation hours credited in January of the current year based on completed months of service in the previous year.
- Accrued Vacation: Vacation hours that have been accrued in the current year that would otherwise have been credited in January of the following year. Such vacation hours are completely accrued at 10/31.

An example will make this clearer. An employee was hired in February 1993. He retires on 1/1/11 with his last working day being 12/31/10. The employee has been carrying over 350 hours for several years (based on the maximum number of carryover vacation hours for someone working a 35-hour week). In 2010, he has 189 additional vacation hours (or 27 days) based on his years of service with the County; such vacation was accrued in 2009. During 2010, he accrues his entire 2011 vacation of 196 hours as of 10/31/10. The employee takes 35 hours of vacation (or 5 days) in 2010. This employee's severance payment for vacation will be based on 700 hours (or 100 days). This 700 hours is comprised of

- The 350 hours he carried over from 2009 to 2010.
- The 189 hours of 2010 vacation minus the 35 hours which he utilized in 2010, or 154 hours.
- The 196 hours he accrued in 2010 for 2011. (Note: This is not considered to be "carryover" and is listed on the Request for Severance Pay form as a separate line.)

Thus his actual vacation carryover, for purposes of determining the severance payment, is 504 (350 plus 154). Even though the employee entered 2010 with the maximum vacation carryover of 350 hours, he/she is technically entitled to also carry over the 2010 vacation which he didn't utilize (by apparently not treating this as "carryover").

Although this calculation of vacation carryover does not appear to be in violation of the Code and union contracts, we find it difficult to believe that management's original intent with vacation carryover was this liberal of an interpretation.

Regarding the vacation accrued in 2010 for 2011, County Code Section 26.03.1404A states "In all cases, service requirements for vacation are based on service accumulated as of December 31 of the year prior to receiving vacation, except that any employee attaining his or her fifth, tenth, or fifteenth service anniversary and each service anniversary in excess of fifteen (15) years shall be eligible for the additional increment in vacation days during the year in which he or she attains such service." Thus,

- It is County Policy that an employee earns vacation in the year prior to the year in which he/she is eligible to take such vacation. (Note: Although the Code Section states that it is accrued as of December 31, accrual is based on ten complete months of service, so an individual may be fully accrued as of October 31st.) There are other municipalities that don't have a policy of earning vacation a year in advance.
- For an employee retiring during the calendar year, who would have obtained his/her fifth, tenth, or fifteenth service anniversary (and each service anniversary in excess of fifteen years) in the year after his/her retirement, the calculation of accrued vacation is based upon him/her actually obtaining that service anniversary and being eligible for an additional day(s). For example, an employee who retired in November 2010 with 9 years of service received an additional 5 days of vacation (20 vacation days, not 15) as though she had actually obtained her tenth service anniversary in 2011.

Recommendation

We recommend that management provide to Council an example such as the one we outlined here, so that Council can obtain a better idea of how severance payments of vacation are calculated. We then recommend that the Administration and Council evaluate the policies for payment of unused vacation upon termination (such as the calculation of vacation carryover and the policy of accruing vacation a year in advance), and determine if any changes are warranted (at least for new employees) in light of the County's financial situation.

Management's Response

Management did not provide a response to the recommendation.

Comments & Recommendations - Other Reportable Item

1. Approval of Vacation Carryover

Comment

Accumulated vacation leave, going into a new calendar year, cannot exceed a maximum number of days. For union employees, this amount is either 30 or 50 depending on union affiliation. For non-union classified or unclassified employees, this amount is 50 days. County Code Section 26.03.1404G states "... by approval of the general manager and Chief Human Resources Officer (CHRO), a maximum of fifty (50) days of vacation may be accumulated and carried over, provided at least two (2) weeks of vacation is taken in each vacation year." Union contracts do not require approval of the general manager and CHRO unless the employee wishes to carry over more than 50 days.

Our testing revealed several instances of a non-union employee with a vacation carryover of 50 days at the time of termination from the County's employment. We did not see any evidence for any of these employees that the General Manager (GM) and the CHRO had approved the employee carrying over a maximum of 50 days. Human Resources told us that all non-union employees are permitted to carry over 50 days as a matter of policy. We interpret the Code as saying that approvals of the GM and CHRO are needed if the employee wishes to carry over any vacation at all, whether it's one day or 50 days.

The County Attorney told us that the CHRO and GMs have implicitly or explicitly given their permission because it has been the consistent interpretation of the County that non-union employees are treated the same as union employees. The County has a long history of providing equal benefits to non-union (including appointed) and union employees. To do otherwise would make little sense since it would encourage every non-union employee to petition to join a union. Evidencing this long standing vacation policy, HR annually has communicated to all employees that they may accumulate a maximum of fifty days of vacation provided at least (2) weeks of vacation is taken in each vacation year. In conclusion, although it may be argued that permission is required to accumulate vacation by non-union employees, the record is overwhelming that permission has been granted as a matter of policy to match the vacation accrual benefits of the union employees. Although a code change would make this clearer, it could also be made clearer by an explicit statement in the Personnel Manual.

Recommendation

To clarify whether or not approval is needed for non-union employees to carry over any vacation less than or equal to 50 days, we recommend that Human Resources Management consider making a Code change and/or revising the Personnel Manual.

Management's Response

Management did not provide a response to the recommendation.