



PTO CONVERSIONS – AE WHITEPAPER

Introduction

When converting from traditional sick leave and vacation to a Paid Time Off (PTO) system, there are multiple important considerations, including financial and cultural, as well as practical issues. PTO works best in a culture where personal responsibility and accountability are core values. In work groups that do not like to be micro-managed and wish to be treated as adults, workers find PTO consistent with a high level of personal responsibility.

PTO allows employees to take time off as needed without the restrictions imposed by traditional time-off policies. This approach gives employees a certain number of days that are put in a leave “bank.” As employees make “withdrawals,” the leave bank diminishes. It eliminates the problem of employees “calling in sick” for other reasons, such as ski days or to care for a sick child. With PTO, employees can use their allotted days however they wish, without having to have specified reasons. This can also be a big help to employers, since they can ask that employees try to schedule PTO days in advance whenever possible, so employers can better plan for lost workdays, and it's a relatively easy way for employers to be more family friendly.

When considering PTO plans, companies should determine if the company can handle the flexibility this option offers. Also, it's important that the policy is coordinated with other company leave policies such as family and medical leave. Finally, before implementing PTO, it is important to take into account all the factors below:

Key Considerations When Converting to PTO

The following factors are several important considerations gleaned from employers who have converted to a PTO structure from a traditional structure:

- Liability and Cost – Converting from traditional sick leave and vacation to PTO is frequently viewed by regulatory agencies as converting “sick leave” to “vacation”. This means that in many states (including Montana), previously forfeited sick leave must now be paid out just like vacation upon separation. For mature organizations where employees have substantial sick leave balances, this can be a significant cost consideration.
- Culture – PTO works best in a culture of personal responsibility. The reason for staying with conventional sick leave and vacation is that it is a tighter system where employee abuse is suspected or prevalent. For example, once sick leave is converted to PTO, it becomes much more difficult to request a doctor's notice for one or two day absences, or to impose a waiting period prior to sick leave payment.
- Market Competitiveness – As mentioned above, PTO is sometimes demanded by certain work groups who “expect” this type of flexibility with paid time off, especially in key positions and younger workers.
- Revision of Policies – Often leave, retirement and other policies contemplate or explicitly address the term “sick leave”. Many states (including Montana) view a

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- conversion to PTO as converting “sick leave” to “vacation”, thus the change can impact policies as well as interpretation under state and federal law.
 - For instance, requiring a pregnant employee to utilize “sick leave” while on pregnancy disability may be lawful, whereas a policy requiring that same pregnant employee to use PTO on disability would be unlawful (California for example).
 - Also, employee notice and medical verification policies may need to be revised as there have been examples of employees calling in on the morning of the absence, with little or no notice, and advising that they are taking a “PTO” day. This behavior might have been limited or prohibited under traditional sick leave policy.
 - Also be mindful of Exempt v Non- Exempt issues for salaried employees with partial PTO days on the books in terms of docking salary.
- Record Keeping – Another consideration is tracking of PTO. If PTO is accrued on a payroll cycle basis, utilization should be reconciled on the same basis. Many payroll systems and HR software systems are available to help with this task, and tracking should be planned prior to roll out.

PRO'S

Easier to administer (single leave bank)

Employees have greater flexibility

Encourages honesty

Reduces absenteeism

Preserves employees' privacy (HIPAA)

Recruitment & retention tool

Total PTO is usually less than the sum available
under separate leave programs

Helps meet the needs of a diverse workforce

Encourages responsible time management

May reduce disruptive, unscheduled absences

Improves planning for staff coverage

CON'S

Still have to track & monitor certain leave (i.e., FMLA, worker's comp, etc.)

May lead to “presenteeism” (employees coming to work ill)

All PTO must be paid at separation from employment

Equity difficult to determine when converting (leave benefits accrue at different rates)

Gives employees fewer overall days off than if allotted separately

Employees use all PTO (some don't use full allotment of sick leave)

Employees gone more often

May not suit the company culture

PTO Program Conversion Involves Four Phases:

1. Assessment
 - **See Key Considerations Above**
 - **Addressing the Perception of a "Take Away":** Converting to PTO means combining vacation, sick days, personal days, and other time off into one bank.

Employers almost never credit the entire amount of sick time to PTO banks.

Therefore, employers need to address the perception that employees are losing sick time. Several employers base conversion on the statistics that the average number of sick leave days allotted is 8 days, and employees typically use 5 days in a given year. Based on this ratio, an employer could convert 60% of sick days to PTO and couple it with an explanation about trade-offs.

- **Dealing with Accumulated Sick Time:** Some employers allow the accumulation of unused sick time as an incentive not to use it. (This practice drives accountants crazy). The accumulated time may be used in some of the following ways: to satisfy a waiting period for short-term disability (STD) benefits (or long-term disability – LTD - benefits); as a pay-out upon separation, typically at a reduced percentage (50%); or it is simply forfeited. Employers may seize the opportunity to clean up their balance sheet and pay out a portion of the accumulated time or convert it to PTO. This approach softens the blow of the perceived take away mentioned above. However, an employer's flexibility in dealing with accumulated sick time depends on its written policy and practice with regard to payouts. Be careful not to create a claim for unpaid fringe benefits.
- **Exhausting PTO:** Employees who use all of their PTO are unpaid for additional absences and may be subject to discipline through an employer's attendance policy. Some traps for the unwary include: the prohibition on salary docking for exempt employees; additional unpaid leave as an accommodation under the ADA, and discrimination claims under the ADA.
- **Administering FMLA:** FMLA administration becomes more challenging in a PTO program since the employer is not necessarily aware of the reason for an absence. A serious health condition under the FMLA triggers an obligation to notify an employee of his or her FMLA rights and starts the counting of the time against the 12 weeks of leave. Employers must also address the concurrent use of PTO and FMLA leave in their policies.
- **Integrating STD, LTD and other Leave Programs:** Some sick leave policies were designed to integrate with the waiting period for STD and LTD benefits. A move to PTO creates a disconnect. The disconnect can be mitigated by allowing an employee with accumulated sick time to use it to satisfy the waiting period if he or she becomes eligible for STD or LTD benefits. Otherwise, PTO or unpaid time is used during the waiting period.
- **Contesting Unemployment Claims:** An employer's proof of willful misconduct to deny unemployment benefits will generally look at the incident that gave rise to the discharge. If the reason is a violation of employer's attendance policy, the employee can show that the violation was not his or her fault. An employee who is fired for excessive absences after "squandering" PTO, may still be eligible for unemployment if the absence that gave rise to termination was for a legitimate illness.

2. Design

- Must include: Scope, Features, Extended Benefits, Eligibility, Procedures, Structure, Administration, and Transition
- Drafting a Policy: A written policy on PTO is necessary and it should address at least the following areas:

- Accrual Basis or Award Basis
- Notice of Absence
- Unused PTO carryover or forfeiture
- Concurrent use of FMLA and PTO
- Consequences of Exhausting PTO
- Discipline/Discharge

3. Implementation

- Determine allowable number of days;
- Establish eligibility requirements;
- Create notification process; and
- Outline restrictions.
- Clearly present how benefit changes will affect each employee, include a “FAQ sheet” and solicit feedback prior to implementation to address employee concerns.

4. Monitoring

- Managers may ask employees for advance notice prior to using leave. Also, companies can require that employees complete a leave request form and obtain their manager's approval beforehand. The PTO policy must contain clear guidelines on what happens to unused leave and should coordinate with other company leave policies (e.g., maternity/paternity or family and medical leave).
- The organization should regularly review and assess its benefits program to monitor associated costs, value and competitiveness.

Payroll Considerations:

In regards to payroll processes, converting to PTO usually takes the form of a two-step process:

- Step One – Accrual: This process is fairly straightforward. Three (3) weeks of vacation (accrued monthly for example) equals fifteen (15) days of PTO. Five (5) days of sick leave equals five (5) days of PTO, for a total of twenty (20) days of PTO per year.
 - (Holidays are most often considered separately from PTO and remain unchanged. One note of caution here;
 - Montana prohibits “use it or lose it” provisions that apply to vacation (not so for sick leave). In this case, be sure to carefully draft PTO policies such that employees with full PTO banks “cease accruing” PTO v lose existing benefits.
 - The primary argument against lump-sum awards arises from a concern regarding employees whose employment is terminated early in the year, and who have used more time than they’ve actually “earned.” Similarly, even in situations where the employee hasn’t used more time than they’ve “earned,” lump-sum awards can result in employers having to payout the entire unused vacation balance upon termination.
- Step Two – Conversion of Existing Balances: Most employers typically convert vacation balances one to one to PTO. Sick leave balances, on the other hand are often not

converted in the same manner. The employer must strike a balance between rewarding employees who do not have balances and effectively penalizing those employees who have built large sick leave balances. Here are several methods commonly used for this conversion of sick leave to PTO:

1. The existing balances go away as of a date certain in the future;
2. A grace period is implemented (i.e., six months) in which the sick leave can be utilized (if sick) and may be cashed out in part or in total at year end;
3. The sick leave balance maintained indefinitely;
4. 50% of the sick leave balance is converted to PTO;
5. 33% of the excess sick leave balance is subtracted annually until used or removed.

NOTE: Grandfathering of existing sick leave balances may be a major issue to consider. A conversion to PTO must be carefully planned and solidly communicated as part of the transition

Timing the Change Over to PTO:

Changes in leave policies should be coordinated with either the end of the leave year period or some other workplace change like moving to a four-day workweek. The obvious choice is converting to PTO bank at the end of the year, since most employers administer their time off programs on a calendar/fiscal year. For employers using anniversary date leave years, it is too difficult administratively to run dual programs, so they should pick a date and change over for everyone.

Conclusion

The creation and administration of vacation policies can be one of the hottest button issues that employers face on a regular basis. Employees have certain beliefs about their rights in this regard, and while the law may not fully support such expectations, failing to have a clear policy that has been adequately explained to employees will inevitably lead to the perception of unfair treatment, and the morale and possibly legal implications that such a perception carries.

However, a PTO program can help your company create a worker-friendly environment and, when implemented successfully, can help decrease absenteeism and reduce turnover.

In the final analysis, the decision to convert or not convert to PTO should be made based on the range of factors as outlined in this summary.

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