ACCOUNTING FOR COMPENSATED ABSENCES
(GASB STATEMENT 16)

INTRODUCTION

School districts are required to report a liability on their balance sheet for leave earned by employees. GASB Statement 16, Accounting for Compensated Absences, provides specific guidance on how this leave liability should be calculated. Statement 16 does not deal with presentation issues, such as whether the compensated absences liability should be reported in governmental funds or in the General Long-Term Debt Account Group (GLTDAG).

The effective date of Statement 16 was for financial statement fiscal years beginning 1993-94.

Statement 16 provides separate guidance for vacation leave and unused sick leave to be paid at termination.

Decision trees showing key elements for each type of leave follow at the end of this section.

Reference related journal entries No. 1 and 16 in Chapter VII, Section GLTDAG in the Accounting Manual for School Districts.


VACATION LEAVE

Statement 16 requires employers to report a liability for vacation leave earned by employees when both the following two criteria have been met:

(1) The vacation leave is related to employee services already rendered; and

(2) Eventual payment to the employee is considered probable.

"Payment" means compensation through paid time off or some other means, such as cash payments at termination or retirement. Consequently, accumulated vacation leave at fiscal year-end should be accrued for time that will be taken off by the employee in a subsequent fiscal year and paid through the employee's regular pay. This issue often confuses employers because they do not see a cost increase when vacation time paid is included in next year's salary. GASB, however, considers there to be an imbedded cost because less work is accomplished in the next year.

The amount of vacation leave liability should be valued using current salary costs (that is, pay rates in effect as of fiscal year-end). This rule does not apply if employees are compensated for leave at some other rate. For example, the salary rate in effect at the time leave was earned by the employee. In this case, the liability should be valued using this other rate.
The liability should also reflect any salary-related payments directly and incrementally connected with leave payments to employees (employer FICA, employer Medicare, eligible contributions to the state retirement system) and are applicable to payments made upon termination. For example, a retirement contribution is made for accrued vacation paid upon termination for employees in TRS 1 and PERS 1, but not for employees in TRS 2 and PERS 2. Statement 16 requires inclusion of retirement for all TRS 1 and PERS 1 accrued vacation, but none is to be included for TRS 2 or PERS 2 accrued vacation. (Note: Salary-related benefit rates should take into account factors such as employees whose salaries exceed the maximum social security withholding. Salary-related payments would not include life insurance premiums and health care premiums paid on behalf of employees.)

The liability for vacation leave should include nonvested leave earned by employees that is expected to vest. For example, assume new employees earn one day of vacation leave per month, but may not take any leave prior to completing a six-month probationary period. Further assume that employees not completing the probationary period forfeit any leave earned during that period. The employer would then accrue leave earned by new employees to the extent those employees are expected to successfully complete the probationary period.

Conversely, the liability for vacation leave should not include accumulated amounts expected to lapse. When determining the effect of lapsing vacation leave on the amount of the vacation leave liability reported at fiscal year-end, it is important to pay attention to the "flow assumption," that is, whether employees are considered to use their most recently earned vacation days first or last.

**SICK LEAVE**

Statement 16 prohibits the accrual of sick leave payments made to employees for time taken off on account of illness or other medical-related reasons because this is not considered a true liability since it is contingent upon a future event beyond the control of both the employer and employee. It does, however, require that employers report a liability for unused sick leave to be paid at termination.

Statement 16 sets forth the following two different approaches for measuring this liability:

1. **Termination Payments Method:** Under this approach, a district calculates the amount of sick leave to be paid upon termination based upon past experience in making such payments.

2. **Vesting Method:** Under this approach, a district estimates the liability for sick leave payouts by calculating the amount of sick leave expected to become eligible for payout at termination.

Using either method, the liability includes salary-related payments (benefits) connected with termination payouts for unused sick leave. Also, both methods require the use of current salary rates unless compensation is at some other rate. For example, the salary rate in effect at the time the leave was earned by the employee, in which case that rate is used instead.

Further, if any unused sick leave is applied to an employee's service credits to qualify the employee for retirement, that unused sick leave must be removed from the amount available to be paid out at termination.

In choosing which method to use, several observations must be made. For example, the vesting method may be the more practical approach in situations where a district does not have adequate historical data to
establish past sick leave payout patterns. Larger districts may choose to use samples to avoid the need to collect and manipulate data for numerous employees. Similarly, past sick leave payout patterns (termination payments method) may be of limited benefit for districts with a relatively small number of employees.

Some leave eligible for payout upon termination may eventually be used for illness. Consequently, the liability calculated using the vesting method is likely to include an amount for sick leave that will be used to compensate employees for time taken off on account of illness. In this case, GASB allows the leave within the liability based upon cost-benefit considerations.

Note also the time focus of the two methods. The termination payments method focuses on several past periods. The vesting method focuses primarily on data as of the balance sheet date.

It should be observed that the termination payment method automatically reflects the amount of currently unvested sick leave that will eventually vest. Under the vesting method, a district should adopt a policy for determining that amount.

Normal accounting treatment applies when recording the compensated absences liability. Use the appropriate governmental fund to record the liability if the employee will be paid with current available resources (as would occur when the employee has retired by August 31 and will receive payment for accrued vacation and unused sick leave by October 31). Use the General Long-Term Debt Account Group (GLTDAG) to record the liability when there is uncertainty as to when the employee will retire and/or receive payment or when current available resources will not be used to liquidate the liability.

**TERMINATION METHOD CALCULATIONS**

There are at least three different ways the termination payments method for sick leave can be applied in practice: (1) The "ratio" approach, (2) the "days paid" approach, and (3) the "amount paid" approach.

"Ratio" Approach

This approach appears to be one of the simpler calculation methods. The liability for unused sick leave is calculated using the historical ratio of sick leave paid to sick leave accumulated. Refer to Exhibit A when considering the following steps:

1. The employer prepares a list of sick leave payouts for the past several years (in this example, a previous five-year period), as well as a list of year-end sick leave balances in dollars for those same years.
   
   (See below: This amount includes vesting and nonvesting sick leave.*)

2. The employer then totals the sum of sick leave payouts ($8,026) and the sum of year-end sick leave balances ($167,840) for the five-year period.

3. The employer then calculates the ratio of sick leave payouts to year-end sick leave balances ($8,026/$167,840 = 4.8%).

4. This rate can then be applied to the current sick leave balance ($42,710) and adjusted for salary-related payments (7.65% of payroll) to calculate the liability for payouts of unused sick leave at termination (4.8% x $42,710 x 1.0765 = $2,207).
### EXHIBIT A

**Assumptions Underlying "Ratio" Example**

<table>
<thead>
<tr>
<th>Year</th>
<th>Sick Leave Payouts</th>
<th>Total Sick Leave Balance*</th>
</tr>
</thead>
<tbody>
<tr>
<td>19X1</td>
<td>$1,075</td>
<td>$21,500</td>
</tr>
<tr>
<td>19X2</td>
<td>1,266</td>
<td>28,133</td>
</tr>
<tr>
<td>19X3</td>
<td>1,650</td>
<td>36,000</td>
</tr>
<tr>
<td>19X4</td>
<td>2,010</td>
<td>40,020</td>
</tr>
<tr>
<td>19X5</td>
<td>2,025</td>
<td>42,187</td>
</tr>
<tr>
<td>19X6</td>
<td></td>
<td>$42,710</td>
</tr>
</tbody>
</table>

#### "Days Paid" Approach

Under this approach, the sick leave liability is calculated on the basis of sick leave days paid in the past. Refer to Exhibits B and C (illustrative examples shown are from these exhibits) when considering the following steps:

1. The employer prepares a list of employees who have terminated during the past several years (in this example, the preceding five-year period as illustrated in Exhibit C).

2. For each employee terminated during that five-year period, the employer lists (a) the number of unused sick leave days payout at termination, (b) the total years worked, and (c) the total sick leave payout amount. These amounts are then totaled (70 days of paid unused sick leave, 60 years of service, and $2,208 sick leave payout for terminated employees).

3. State of Washington employees are paid at 25 percent of their regular pay rate for unused sick leave. Accordingly, the total number of paid unused sick days (70 days) is first multiplied by the average daily pay rate for current employees ($96/day), and then reduced to the pay rate in effect for termination payments (70 days x $96/day x 25% = $1,680).

4. The adjusted value of sick leave ($1,680) is divided by the total service years of terminated employees to calculate the sick leave payout per year of service ($1,680/60 years of service = $28/year of service).

5. Once the sick leave payout per year of service has been calculated, it is applied to the years of service of current employees (in this example, 38 years) and adjusted to reflect salary-related payments (7.65% of payroll). The result is the liability for unused sick leave payouts at termination (38 years of current employee service x $28/year of service x 1.0765 = $1,145).

Larger districts may consider using samples to eliminate the need to provide detailed information for numerous employees.
"Amount Paid" Approach

Under this method, the sick leave liability is calculated on the dollar value basis of sick leave paid in the past. Refer to Exhibits B and C when considering the following steps (illustrative amounts are from those exhibits):

(1) The employer prepares a list of employees who terminated during the past several years (in this example, the preceding five-year period as illustrated in Exhibit C).

(2) For each employee terminated during that period, the employer lists both (a) the total years worked and (b) the amount of unused sick leave payout at termination. The number of years worked for terminated employees is then totaled (60 years).

(3) The amount of sick leave paid in each of the preceding years must then be converted into current year dollars. The rate used reflects the average yearly rate of pay increases during the five-year period. The district then calculates the sum of sick leave payouts in current year dollars ($2,494).

(4) Because of their seniority, terminating employees are often paid at a higher daily pay rate than other employees. For example, the average daily pay rate for current employees may be 80 percent of the average daily pay rate of terminating employees. Therefore, the sum of sick leave payouts must be adjusted accordingly ($2,494 x 80% = $1,995).

(5) The $1,995 is then divided by the total years of service of terminated employees to calculate the sick leave payout rate per year of service ($1,995/60 years of service = $33.25/year of service).

(6) Once the sick leave payout per year of service has been calculated, it is applied to the years of service of current employees (38 years) and adjusted to reflect salary-related payments (7.65 % of payroll). The result is the liability for unused sick leave payouts upon termination (38 years of current employee service x $33.25/year of service x 1.0765 = $1,360).

Again, larger districts may consider using samples to eliminate the need to provide detailed information on numerous employees.

EXHIBIT B

Assumptions Underlying "Days Paid" and "Amount Paid" Examples

| Pay rate for termination payments:                   | 25% |
| Salary-related payment ratio:                        | 7.65% |
| Current average daily salary:                        | $96 |

<table>
<thead>
<tr>
<th>Current Employees:</th>
<th>Employee</th>
<th>Length of Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td>8 years</td>
</tr>
<tr>
<td>2</td>
<td></td>
<td>1 year</td>
</tr>
<tr>
<td>3</td>
<td></td>
<td>10 years</td>
</tr>
<tr>
<td>4</td>
<td></td>
<td>16 years</td>
</tr>
<tr>
<td>5</td>
<td></td>
<td>3 years</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td>38 years</td>
</tr>
</tbody>
</table>

EFF DATE         SUPERSEDES   APPX   SEC   PAGE
9-1-99            9-1-95        D      GASB 16  5
EXHIBIT C

Schedule of Employee Terminations
Last 5 Fiscal Years

<table>
<thead>
<tr>
<th>Employee</th>
<th>Year of Termination</th>
<th>Sick Day Payout</th>
<th>Years Worked</th>
<th>Sick Leave Payout</th>
<th>Adjusted Payout (4%/yr.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>19X1</td>
<td>15</td>
<td>13</td>
<td>$567</td>
<td>$690</td>
</tr>
<tr>
<td>B</td>
<td>19X2</td>
<td>0</td>
<td>7</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C</td>
<td>19X3</td>
<td>25</td>
<td>14</td>
<td>660</td>
<td>743</td>
</tr>
<tr>
<td>D</td>
<td>19X4</td>
<td>30</td>
<td>20</td>
<td>981</td>
<td>1,061</td>
</tr>
<tr>
<td>E</td>
<td>19X5</td>
<td>0</td>
<td>6</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>TOTALS</td>
<td>70</td>
<td>60</td>
<td></td>
<td>$2,208</td>
<td>$2,494</td>
</tr>
</tbody>
</table>

VESTING METHOD CALCULATION

Under the vesting method, the sick leave liability is based upon leave balances for current employees that are likely to become eligible for termination payments. Refer to Exhibits D and E when considering the following steps (amounts used are from those exhibits):

1. Typically, employees obtain the right to be compensated for unused sick leave upon completing a certain number of service years. In that case, the district should establish an eligibility policy. It must decide at what point it becomes probable an employee will, in fact, complete the required service period. Turnover is often different for various classes of employees; therefore, the milestone selected may be different for each class of employees (for example, kitchen employees--10 years; professional/technical employees--8 years).

2. The sick leave balance for each current employee who has met the appropriate milestone (for example, kitchen employees--with more than 10 years service) should then be reduced to reflect any cap on sick leave payouts (for example, 180-day maximum).

3. State of Washington employees are paid at 25 percent of their regular pay rate for sick leave payouts on a maximum of 180 accrued days. Accordingly, the sick leave balance for an employee (180 days) is first multiplied by the employee's daily pay rate ($65/day), and then reduced to the pay rate in effect for termination payments (180 days x $65/day x 25% = $2,925).

4. The employer then calculates the sum of these amounts for all employees and adjusts it to reflect salary-related payments (for example, employer FICA and Medicare) to determine the total liability for unused sick leave payouts ($13,823).
EXHIBIT D

Assumption for Illustration of Vesting Method

<table>
<thead>
<tr>
<th>Employee</th>
<th>Class</th>
<th>Balance</th>
<th>Pay Rate</th>
<th>Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>A</td>
<td>182 days</td>
<td>$65/day</td>
<td>20 years</td>
</tr>
<tr>
<td>2</td>
<td>B</td>
<td>84 days</td>
<td>$85/day</td>
<td>7 years</td>
</tr>
<tr>
<td>3</td>
<td>A</td>
<td>122 days</td>
<td>$50/day</td>
<td>17 years</td>
</tr>
<tr>
<td>4</td>
<td>C</td>
<td>300 days</td>
<td>$95/day</td>
<td>22 years</td>
</tr>
<tr>
<td>5</td>
<td>A</td>
<td>20 days</td>
<td>$45/day</td>
<td>10 years</td>
</tr>
<tr>
<td>6</td>
<td>C</td>
<td>70 days</td>
<td>$90/day</td>
<td>6 years</td>
</tr>
<tr>
<td>7</td>
<td>C</td>
<td>40 days</td>
<td>$95/day</td>
<td>27 years</td>
</tr>
<tr>
<td>8</td>
<td>B</td>
<td>34 days</td>
<td>$80/day</td>
<td>22 years</td>
</tr>
<tr>
<td>9</td>
<td>A</td>
<td>12 days</td>
<td>$55/day</td>
<td>5 years</td>
</tr>
<tr>
<td>10</td>
<td>A</td>
<td>490 days</td>
<td>$50/day</td>
<td>31 years</td>
</tr>
</tbody>
</table>

Service required to be eligible for sick leave payout: 20 years
Limitations on sick leave payouts: 25% pay/180-day maximum
Salary-related payments rate: 7.65%

Likely to complete 20 years of service:

<table>
<thead>
<tr>
<th>Milestone</th>
</tr>
</thead>
<tbody>
<tr>
<td>Class A</td>
</tr>
<tr>
<td>Class B</td>
</tr>
<tr>
<td>Class C</td>
</tr>
</tbody>
</table>
### Assumption for Illustration of Vesting Method

<table>
<thead>
<tr>
<th>Emp.</th>
<th>Eligible</th>
<th>Service</th>
<th>Accrue?</th>
<th>Days</th>
<th>Sick Pay</th>
<th>Pay Rate**</th>
<th>Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>10 years</td>
<td>20 years</td>
<td>Yes</td>
<td>180*</td>
<td>$16.25/day</td>
<td></td>
<td>$2,925</td>
</tr>
<tr>
<td>2</td>
<td>8 years</td>
<td>7 years</td>
<td>No</td>
<td>84</td>
<td>N/A</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>3</td>
<td>10 years</td>
<td>17 years</td>
<td>Yes</td>
<td>122</td>
<td>$12.50/day</td>
<td>$23.75/day</td>
<td>1,525</td>
</tr>
<tr>
<td>4</td>
<td>12 years</td>
<td>22 years</td>
<td>Yes</td>
<td>180*</td>
<td>$23.75/day</td>
<td></td>
<td>4,275</td>
</tr>
<tr>
<td>5</td>
<td>10 years</td>
<td>10 years</td>
<td>Yes</td>
<td>20</td>
<td>$11.25/day</td>
<td></td>
<td>236</td>
</tr>
<tr>
<td>6</td>
<td>12 years</td>
<td>6 years</td>
<td>No</td>
<td>70</td>
<td>N/A</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>7</td>
<td>12 years</td>
<td>27 years</td>
<td>Yes</td>
<td>40</td>
<td>$23.75/day</td>
<td></td>
<td>950</td>
</tr>
<tr>
<td>8</td>
<td>8 years</td>
<td>22 years</td>
<td>Yes</td>
<td>34</td>
<td>$20.00/day</td>
<td></td>
<td>680</td>
</tr>
<tr>
<td>9</td>
<td>10 years</td>
<td>5 years</td>
<td>No</td>
<td>12</td>
<td>N/A</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>10</td>
<td>10 years</td>
<td>31 years</td>
<td>Yes</td>
<td>180*</td>
<td>$12.50/day</td>
<td></td>
<td>2,250</td>
</tr>
</tbody>
</table>

Salary-related payments***

<table>
<thead>
<tr>
<th></th>
<th>982</th>
</tr>
</thead>
</table>

$13,823

*Sick leave payouts limited to 180-day maximum

**25% of regular pay rate

***7.65%
Compensated Absences
Vacation Leave

No further action (since any such payment would be a gift of public funds)

(1) Through time off or some other means such as cash payments at termination or retirement.

(2) Should include nonvested leave that is considered likely to vest and should not include balances that are expected to lapse.

(3) This rule do not apply if employees are compensated for leave at some other rate (e.g. the salary rate in effect at the time the leave was earned by the employee), as is sometimes (but rarely) the case.

(4) Only those benefits that are applicable to payments made upon termination may be accrued. For example, in the state of Washington a retirement contribution is made for accrued vacation paid upon termination for employees in TRS1 and PERS1 but not for TRS2 and PERS2. GASB 16, therefore, requires inclusion of retirement for all TRS1 and PERS1 accrued vacation, but none is to be included for TRS2 or PERS2 accrued vacation.

Vacation leave must be accrued (2)
Use current salary costs(3)

Add salary related payments that are directly and incrementally connected with leave payments to employees

-employer FICA
-employer Medicare
-eligible contributions to the state retirement system(4)

Eventual payment considered probable?
No

No further action

Yes

Vacation leave relates to past service?
No

Yes
Compensated Absences
Unused Sick Leave
To Be Paid Out At Termination

Calculate Liability based on one of the following:

- **Past experience** ("Termination Payments" method).
  
  Calculate using one of the following:
  
  - "Ratio" - Calculate amount that eventually will be paid off based on ratio of sick leave payments to outstanding sick leave balances at year end in the past.
  
  - "Days Paid" - estimate number of days that eventually will be paid off based on number of days paid in the past.
  
  - "Amount Paid" - Estimate dollar value that eventually will be paid off based on dollar value paid in the past.

- **Amount of sick leave expected to become eligible for payment upon termination** ("Vesting" method).

  Calculate as follows:
  
  Determine point at which it becomes probable that an employee will complete the required service to be eligible for compensation. Note: Different classes of employees may be treated differently.
  
  Balance of days times daily pay rate times pay rate in effect for termination payments.
  
  Calculate the sum of these amounts for all employees.

Add benefits that are directly and incrementally related to leave payments to employees.

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