

Legislative Audit Division

State of Montana



Report to the Legislature

November 2006

Performance Audit

Pay Plan 20: The State's Alternative Pay Plan

State Personnel Division

Department of Administration

This report contains information about Pay Plan 20, which is the State's alternative pay plan. Recommendations for changes include:

- ▶ Re-evaluating the discounting procedure for market analysis.
- ▶ Identifying and defining the relevant labor market for Montana.
- ▶ Developing and documenting formal guidelines for use in analyzing and establishing occupational market rates.
- ▶ Approving market rates for all occupations.
- ▶ Establishing a system for compiling and monitoring recruitment and retention data.

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November 2006

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of the state's Pay Plan 20. Pay Plan 20 is a market-based pay plan with flexibility for agency managers to award employee pay increases based on performance. As of July 2006, the majority of state agencies and state employees are using Pay Plan 20. The Department of Administration is responsible for administering the state's pay plans.

Our report contains information regarding Pay Plan 20, establishment of market pay rates, and changes occurring in the state's compensation philosophy and organizational culture. We make recommendations for improving the department's market analysis process including re-evaluating the discounting procedure, defining the relevant labor market, developing guidelines for staff, and approving all market rates, as well as monitoring desired outcomes. A response from department officials is contained at the end of the report.

We wish to express our appreciation to all department personnel for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Scott A. Seecat

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Legislative Auditor

Legislative Audit Division

Performance Audit

Pay Plan 20: The State's Alternative Pay Plan

State Personnel Division

Department of Administration

Members of the audit staff involved in this audit were Bridget Butler,
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Introduction

The 1997 Legislature passed House Bill 13 directing the Department of Administration to develop an alternative classification and pay system for state employees. This alternative system is Pay Plan 20.

Background

Pay Plan 20 is referred to as the State of Montana broadband pay plan (broadbanding). Broadbanding is a method of defining occupations and associated pay ranges to enable more flexibility in pay administration. Broadbanding consolidated the state's 25-grade pay matrix from Pay Plan 60 into nine pay bands. Under Pay Plan 20, agency management has flexibility to award pay increases according to their own pay policies and within agency approved operating plans. There are several types of pay adjustments available including market-based, performance-based, results-based, situational pay, strategic pay, and bonus pay. These pay adjustment types are suggested through department guidelines, but not mandated by statute, rule, or policy.

While Pay Plan 20 is called an alternative pay plan, the majority of state agencies are using it to compensate employees. State agency managers consider its flexibility a major benefit. Flexibility in pay administration is a significant change for the State of Montana, and this flexibility has an impact on the compensation philosophy of the state. First, the structure of Pay Plan 20 is based on comparable market salaries, and most agencies have focused on market-based pay. The second part of pay administration in Pay Plan 20 is performance-based pay. The plan provides agency managers flexibility to adjust employee pay based on various needs and accomplishments. The performance element of Pay Plan 20 has not been fully realized.

Market-Analysis

The Department of Administration is responsible for administering Pay Plan 20. One of the main activities conducted under this responsibility is market analysis. Market analysis is the collection and analysis of salary data from other employers for similar jobs. The results of the market analysis are used to establish market pay rates for specific occupations. Overall, the department's market analysis process follows common industry practices used for

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establishing market pay rates. However, we identified several areas where improvements could be made to strengthen the market analysis process.

Discounting Survey Data

In order to approximate the relationship of Montana salaries to national salaries, the department's market analysis process includes an adjustment to national survey data. The department established a 15 percent discount factor using the relationship of Montana to the U.S. median wage.

Discounting survey data is a way to adjust salary figures to more accurately reflect a regional market. However, documentation of the methodology used by the department does not clearly indicate this discount provides the best estimate. The department currently uses a general discount factor of 15 percent for all occupations, but median rankings are also available for individual occupations. If the department used the factor associated with each occupation rather than a general discount factor, it could provide a more practical market rate for each occupation. We believe the department should re-evaluate and document its discounting methodology to better reflect market.

Competitive Labor Market

For compensation, the term market refers to the collective group of employers that compete for employees. Statute, while limited for the alternative pay plan, does indicate pay is to be established based on the relevant labor market. However, Montana's relevant labor market is not defined in rule or policy.

The department developed its process without specifically defining market. Survey data that is readily available, commonly used, and lower in cost to retrieve is used to set market rates. According to division management, more specific survey data is available, which may be more relevant to Montana's competitive labor market. The department should identify this relevant labor market and develop a definition based on current practices and input from state agency personnel.

Criteria to Guide the Process

Department staff regularly make decisions regarding use of salary survey data for calculating market rates. There are no set criteria on when to use survey data and when to eliminate it from calculations. Division personnel set market rates for over 400 occupations, so it is important to have formal guidelines to help ensure consistent decision-making in calculating market rates.

While some judgment needs to be applied, formal guidelines are needed to help ensure consistency in similar situations. In order to facilitate consistency between analysts, as well as facilitate consistency for the same analyst from year to year, the department should develop formal guidelines for decision-making. The department could incorporate these guidelines into current analysis tools for use during group discussions and finalization of markets.

Market Analysis by Other Entities

While most agencies adopt market rates established by the department, there are some occupations in which market rates are established by other state agencies. For example, one agency chooses not to adopt department market rates, and instead establishes its own market rates. There is no policy regarding how market rates should be established for unique occupations, and how the process should be conducted when this occurs.

According to statute, it is the intent of the legislature that compensation plans for state employees be based on an analysis of the labor market as provided by the department. In order to fully implement the intent of the law, the department should be providing guidance and approving the market analysis for all occupations.

The Compensation System is Changing

The department plans to seek legislation to establish Pay Plan 20 as the State of Montana's main compensation system and move all employees to the new pay plan by July 1, 2007. This proposed change in pay plans is a significant change in compensation philosophy and organization culture. In order to make an informed decision, there are some key questions the Legislature should consider during its discussions of Pay Plan 20.

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Pay Plan Variations

Pay plan variations among state agencies have created differences in pay. The department sets a minimum, market, and maximum pay rate for each occupation. However, employee pay is up to the discretion of agency management. This flexibility allows agency managers to use pay to recruit, retain, and reward employees for performance, competencies, and achievements. With no specific guidance, and variations between agencies in available funding, individual employees in Pay Plan 20, hired for the same occupation but in different agencies, can and do get paid varying amounts within occupational pay ranges. Excluding any pay for performance components, the likelihood of pay inequities is greater. These differences in pay result in competition between agencies for employees with the same skills.

Cultural Change

The concept of broadbanding is a major change in compensation philosophy and organizational culture for the State of Montana. Managers have more flexibility in setting pay for individual employees based on market trends and performance. Employees have more flexibility in individual development and career progression. From an organizational standpoint, the change can be characterized as a move from one of entitlement (everyone gets a pay increase) to one based on performance (employees who perform get pay increases).

Matching the market is sometimes referred to as being externally competitive. Aside from comparison to market rates, performance-based pay is a main component of broadbanding. While Montana's state agencies are not required to implement a performance-based pay component as part of Pay Plan 20, some have done so or have plans to implement this component in the future. By granting managers and supervisors more discretion to determine pay increases, pay for performance increases responsibility for supervision and implementation of performance measurement.

Measuring Outcomes

The idea behind creation of the alternative pay plan was to address recruitment and retention issues by providing agency managers with

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tools to better meet individual agency needs. It has been more than five years since state agencies started transitioning to Pay Plan 20. However, there is no information available indicating whether the alternative pay plan is achieving desired outcomes.

Effective implementation should include an ongoing review of the system. There is no requirement to track and monitor recruitment and retention, employee productivity, or other aspects related to outcomes associated with the pay plan. As a result, each agency is left to its own devices on whether or not to monitor operations. In order to determine the impacts of Pay Plan 20, outcomes need to be tracked and monitored.

Chapter I – Introduction

Introduction

The Legislative Audit Division issued an audit survey on Personnel Classification in November 1997 (97P-08). The conclusion of this survey was to conduct an audit of the state's compensation system after decisions were made by the legislature regarding implementation of a new system. The 1997 Legislature passed House Bill 13 directing the Department of Administration (DofA) to develop an alternative classification and pay system. This alternative system is Pay Plan 20. The Legislative Audit Committee prioritized an audit of Pay Plan 20 after the 2005 Legislative Session.

Audit Objectives

Based on preliminary audit work, we established the following audit objectives:

- ▶ Determine what degree of implementation of Pay Plan 20 has occurred.
- ▶ Determine if desired outcomes of Pay Plan 20 are being achieved.
- ▶ Determine the extent of legislative guidance and related management controls over administration of Pay Plan 20.
- ▶ Determine if Pay Plan 20 pay rates established by the Department of Administration reflect market.

Audit Scope

DofA is the administrator of the state's classification and pay plans, so it was the primary agency under review. While DofA administers Pay Plan 20, other agencies are involved and have responsibilities for pay administration. We conducted the following audit work relative to Pay Plan 20:

- ▶ Analysis of laws, rules, and policies, including other state pay plans.
- ▶ Interviews of DofA personnel with classification and compensation responsibilities.
- ▶ Observations of DofA market pay rate meetings.
- ▶ Review of DofA and other agency records and documentation.
- ▶ Survey of agency human resource personnel.
- ▶ Observations of meetings of the State Pay Special Task Force.

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- ▶ Interviews of personnel and review of related documentation in three selected agencies including:
 - The first agency to transition all employees to Pay Plan 20.
 - The most recent agency to transition to Pay Plan 20 (at the time of audit planning).
 - A smaller agency with only a small group of employees in Pay Plan 20.
- ▶ Survey of a random sample of state employees within the three selected agencies.
 - Survey sent to 135 state employees and 69 responses received from employees in all three agencies (a 51 percent response rate).
- ▶ Review and analysis of information related to compensation systems.

Management Memorandum

During the course of our review, we identified an issue related to Pay Plan 20 which we believe warrants management attention, but is not a subject of a recommendation in this report. We presented the following suggestion to department management.

Communication with Agency Personnel

Based on responses to our employee survey, state employees do not have a complete understanding of Pay Plan 20, nor do they understand the manner in which they are compensated or receive pay increases. One of the main purposes of Pay Plan 20 is to recruit, retain, and reward employees. Therefore, to assist in employee understanding, communication needs to take a more prominent role in the implementation and administration of Pay Plan 20. Effective employee communication helps increase employee awareness of attempts to create internal equity, ensure competitiveness, and reward individual performance. Currently, agencies lack guidance and resources needed to effectively transition and implement Pay Plan 20. The department has established guiding principles, but these are neither specific nor directive, and are not easily located. The department may wish to increase emphasis on centralized communication for Pay Plan 20, including guidance on pay plan implementation and operation that is easy to locate and understand.

Report Organization

The remainder of this report includes a chapter detailing Pay Plan 20, a chapter on establishing market rates, and a chapter outlining key considerations for the alternative pay plan. Specifically, the report discusses:

- ▶ Chapter II - historical information on pay in Montana and details on Pay Plan 20.
- ▶ Chapter III - the market analysis process and recommendations for improvements related to discounting, the relevant labor market, guidance for the process, and approving market rates.
- ▶ Chapter IV - information related to movement toward Pay Plan 20 and related differences in pay administration.

Chapter II – Implementation of Pay Plan 20

Background

According to a Department of Administration (DofA) report, the legislature adopted the first uniform wage and salary plan for state employees in 1975. The statewide classification system and pay plan was enacted to assure state employees were paid similarly for similar work regardless of employing agency or funding source. The plan took the form of a matrix containing 25 vertical grades and 8 to 13 horizontal steps. The Governor and the legislature determined biennial across-the-board increases to the pay plan. DofA surveys of other employers' salary levels, collective bargaining and the state's ability to pay drove pay decisions.

In 1979, the legislature authorized DofA to develop a pay exception program to "mitigate problems associated with difficult recruitment, retention, transfer, or other exceptional circumstances." In 1991, the legislature modified the 25-grade pay matrix, replacing steps with an open-range progression to reflect a more market-based pay philosophy. The 1997 Legislature directed DofA to develop an alternative classification and pay system. This alternative system, Pay Plan 20, is a market-based and competency-based pay plan.

Several Pay Plans Currently Exist

Numerous pay plans exist to address compensation needs of specific occupations. Currently, there are seven Executive Branch pay plans. Aside from Pay Plan 20, other pay plans include:

Statewide Classified Plan (Pay Plan 60) - adopted into statute in 1975 as the state's primary classification and compensation system.

Highway Patrol Officers Pay - enacted into law in 2005, Highway Patrol Officers pay is a subset of Pay Plan 20 which uses specified labor market data to set salaries.

Blue Collar Plan (Pay Plan 62) - enacted in 1979, this is a collectively bargained pay plan for organized trade and craft employees.

Teachers Plan (Pay Plan 64) - also enacted in 1979, this plan covers teachers employed by the Department of Corrections and the Department of Public Health and Human Services.

State Fund Plan (Pay Plan 65) - enacted into law in 1989, compensation laws do not apply to State Fund employees, and they have developed their own plan.

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Medical Professionals Plan (Pay Plan 67) - originally enacted into law in 1979, this plan was created to address problems in recruiting and retaining employees in certain medical professions.

Information Technology and Engineering Plan (Pay Plan 68) - this plan was established by DofA in 1997 as an exception to the Statewide Classified Pay Plan to address recruitment and retention problems.

The following table shows the number of employee positions for all state government pay plans as of July 2006.

Table 1
Number of Positions in State Government Pay Plans
(as of July 2006)

Pay Plan	Employee Positions	Percent
Broadband (20)	7,745	62.99%
Judicial (30)	335	2.72%
Statewide (60)	2,680	21.80%
Exempt (61)	375	3.05%
Blue Collar (62)	645	5.25%
Legislative (63)	113	0.92%
Teachers (64)	31	0.25%
State Fund (65)	263	2.14%
Medical Professionals (67)	22	0.18%
IT & Engineering (68)	87	0.71%
Totals	12,296	100%

Source: Compiled by the Legislative Audit Division from department records.

Per statute, the Board of Regents administers the compensation system for the Montana University System. In addition, salaries of elected officials and judges are based on the average salary of similar

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positions in Idaho, North Dakota, South Dakota, Wyoming, and the current salaries of these Montana officials.

Our audit focused on Pay Plan 20 implementation; however, prior to transition to Pay Plan 20, the majority of state employees were in Pay Plan 60. Comparisons between these two pay plans are made throughout this report.

Alternative Classification and Pay System Developed

At the request of the Governor's Office, the State Personnel Division (SPD) completed a survey of managers and personnel officers in April 1996. The survey was conducted to determine what changes management would recommend to make the compensation system more responsive to state agency needs. Agency personnel completing the survey suggested greater flexibility in employee compensation. Based on the survey results, the Governor directed DofA to develop a competency-based personnel system for state employees to use as an alternative to the statewide compensation system.

Under state law, the department has authority to implement alternative classification systems without first obtaining legislative approval. However, the department sought legislative input on a new compensation system during the 1997 legislative session. House Bill 13 included language directing DofA to develop an alternative classification and pay system consistent with a market-based approach to pay administration. Language in the bill also required emphasis of individual skills, competencies, and contributions.

Development of an alternative classification and pay system included implementation of a number of pilot projects at various agencies during fiscal year 1997-98 including:

- ▶ Department of Public Health and Human Services (social workers)
- ▶ Department of Livestock (brand inspectors)
- ▶ Department of Commerce (managers and executives)

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- ▶ Department of Transportation (technicians)
- ▶ Department of Corrections (probation and parole officers)

Subsequent legislative sessions provided authority to continue development of an alternative pay system, with the 2001 Legislature specifically making an alternative pay plan part of statute.

Section 2-18-303(6), MCA, currently reads as follows:

“(a) The department may develop and implement an alternative pay and classification plan for certain classes, occupations, and work units. Pay for employees in the alternative pay and classification plan may be established and changed based on demonstrated competencies and accomplishments, on the labor market, and on other situations defined by the department.

(b) To the extent that the plan applies to employees within a collective bargaining unit, the implementation of the plan is a negotiable subject.”

Broadbanding

Pay Plan 20 is also referred to as the broadband pay plan. Broadbanding is a method of defining occupations, such as accountant and engineer, and associated pay ranges to enable more flexibility in pay administration. Broadbanding consolidated the 25-grade pay matrix from Pay Plan 60 into nine bands. For example, grades 16 and 17 were consolidated into Pay Band 7. Each band has a broader minimum to maximum range than the ranges for each grade in Pay Plan 60.

How are Positions Placed Into Pay Bands?

Section 2-18-201, MCA, directs DofA to develop a personnel classification plan for all state positions and classes of positions in state service. Each position in state government has to be classified for placement in a pay plan. Classification is a system of categorizing jobs by type and level of work to provide for similar pay between positions.

The classification process involves three basic steps: job analysis, job evaluation, and documentation.

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- ▶ Job analysis involves collecting information about the position through various sources, such as conversations with the supervisor or incumbent, and relies on clear documentation of job duties and responsibilities in a position description.
- ▶ Job evaluation applies the benchmark factoring methodology to determine the appropriate pay band for the job.
- ▶ Documentation summarizes the job analysis and job evaluation in a written statement explaining and defending the classification decision.

Our review of classification determined the process used by DofA for classifying jobs follows standard procedures common to the human resources industry.

Conclusion: The process established by DofA provides a standardized and reasonable methodology for classifying jobs.

Occupational Pay Ranges

Once the classification process is complete, the position is assigned to a corresponding band in Pay Plan 20. Each band has a pay range with a minimum and maximum annual salary. These pay ranges were initially established with pay data from Pay Plan 60 by taking the lowest and highest existing salaries in the various grades, and making them the minimum and maximum for the corresponding pay band. The minimum and maximum salaries are shown in the following table.

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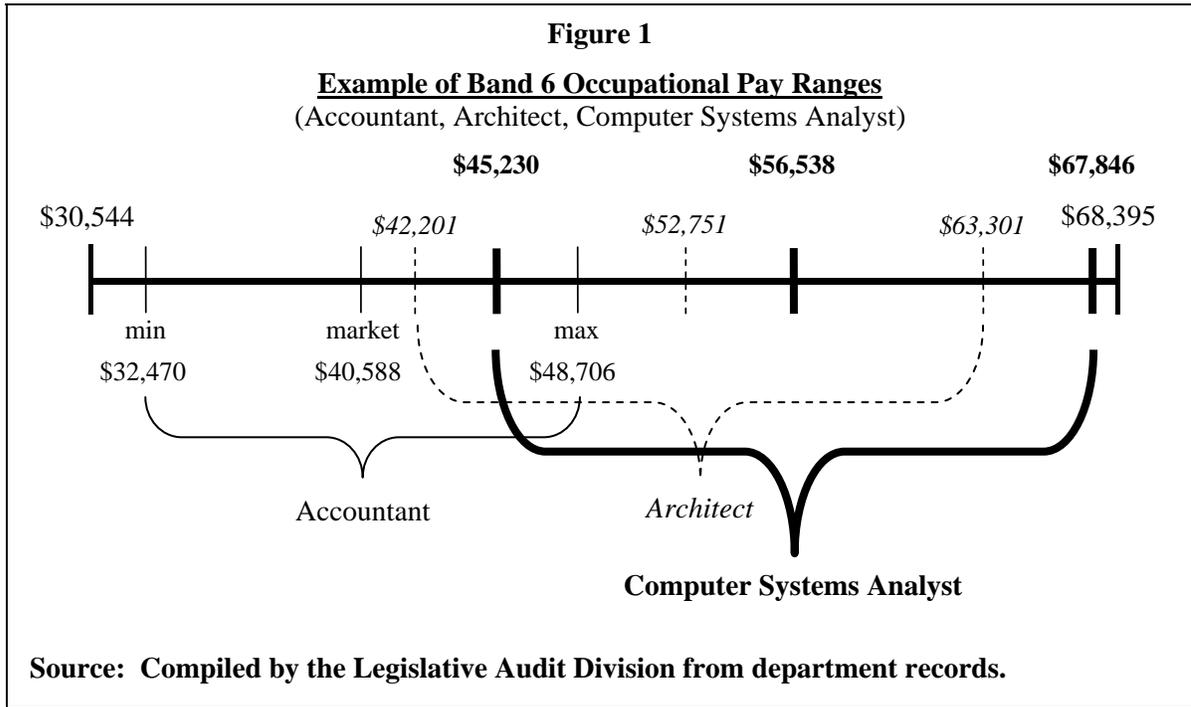
Table 2

Pay Plan 20 Band Ranges
(October 2005-September 2007)

Pay Band	Annual	
	Minimum Base Salary	Maximum Base Salary
1	\$13,048	\$24,642
2	\$15,313	\$29,456
3	\$18,110	\$38,701
4	\$21,477	\$46,599
5	\$25,577	\$56,425
6	\$30,544	\$68,395
7	\$36,667	\$83,116
8	\$44,090	\$112,306
9	\$53,096	\$138,345

Source: Department of Administration.

The broad ranges shown in Table 2 accommodate the individual pay ranges for the various occupations existing in Montana state government. Each class of positions has an established occupational pay range within a band. Occupational pay ranges have a minimum pay rate 20 percent below market and a maximum pay rate 20 percent above market. The following figure provides examples of occupational pay ranges.

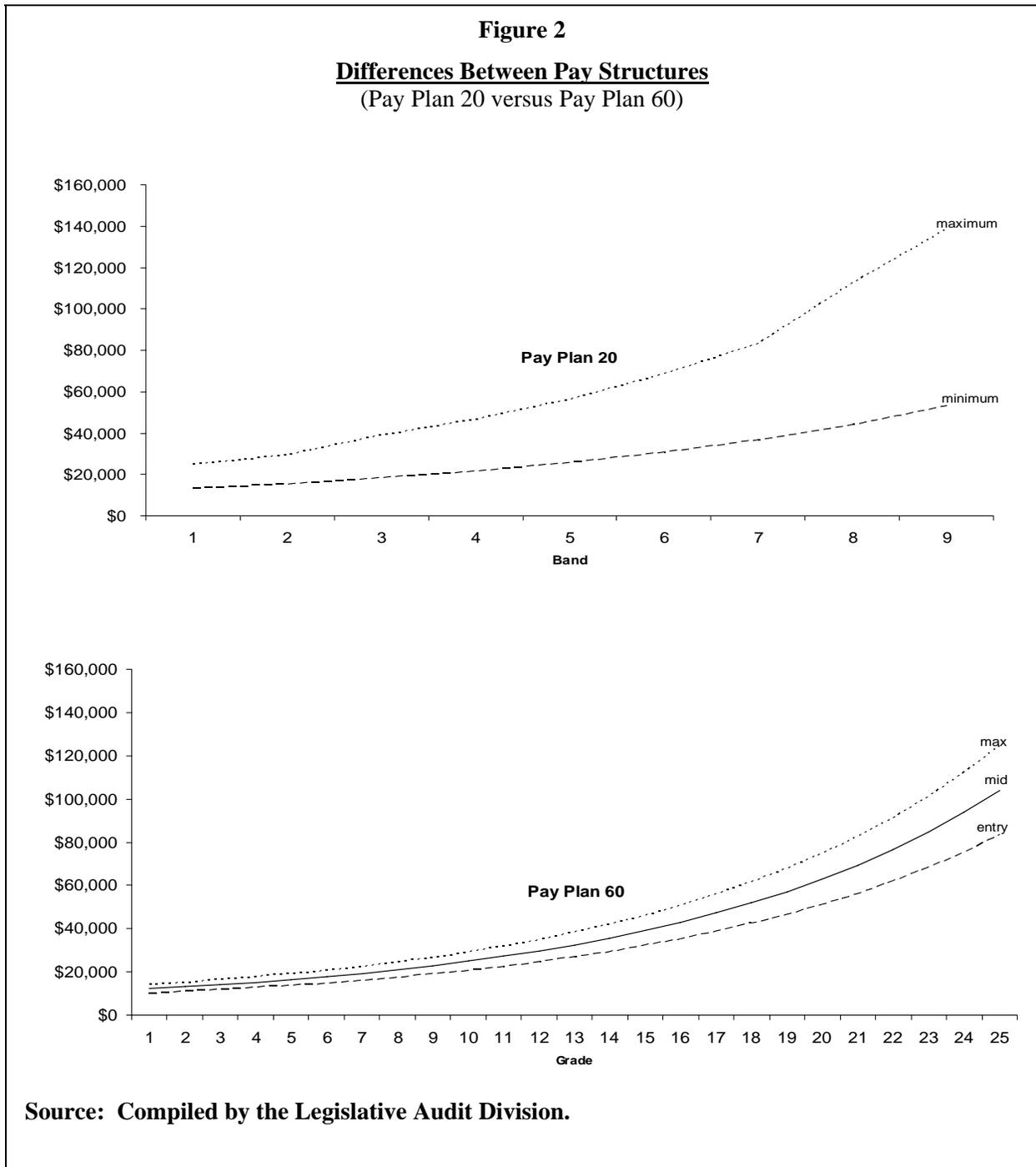


Differences Between Pay Plan 20 and Pay Plan 60

More than 80 percent of Executive Branch state employees are in either Pay Plan 20 or Pay Plan 60. In the past two years agency managers have transitioned the majority of employees from Pay Plan 60 to Pay Plan 20.

One of the more noticeable differences is the structure of the two pay plans. As stated previously, each band in Pay Plan 20 has a broader minimum to maximum range than the grades in Pay Plan 60. What Pay Plan 60 does with 25 grades, Pay Plan 20 does with only 9 bands. In addition, Pay Plan 60 grades include an entry, mid-point, and maximum, while Pay Plan 20 bands have minimums and maximums. This difference can be seen in the following figure.

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There are other differences between the two pay plans, and some of these are listed in the following table.

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Table 3
Comparison Between Pay Plan 20 and Pay Plan 60

Category	Pay Plan 20	Pay Plan 60*
Classification	<ul style="list-style-type: none"> • 1 factor: complexity • benchmark ranking 	<ul style="list-style-type: none"> • 7 factors: complexity; working conditions; occupational knowledge, skills and abilities; management and supervision of others; supervision received; scope and effect of actions and decisions; personal contacts • point factoring
Pay Administration	<ul style="list-style-type: none"> • flexible • market based • management determines pay • various types of increases including pay for performance 	<ul style="list-style-type: none"> • rigid • statutorily based • legislature determines pay • across-the-board increases
Statutory Guidance	<ul style="list-style-type: none"> • limited 	<ul style="list-style-type: none"> • specific
Union Negotiation	<ul style="list-style-type: none"> • collective bargaining • signed agreement 	<ul style="list-style-type: none"> • collective bargaining • signed agreement

* Information is generalized; some exceptions exist.

Source: Compiled by the Legislative Audit Division.

One of the most significant differences noted in the table above is pay administration. Under Pay Plan 20, agency management has flexibility to award pay increases according to their own pay policies and within approved operating plans. There are several types of pay increases available including:

- ▶ Market-Based: adjustments based on market trends and changes.
- ▶ Performance-Based: adjustments based on individual job performance.
- ▶ Results-Based Pay: adjustments based on accomplishments.
- ▶ Situational Pay: adjustments based on specific job-related situations.
- ▶ Strategic Pay: adjustments based on individual agency needs.

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- ▶ Bonus Pay: one-time adjustments based on individual/team performance.

These available types of pay increases are suggested through DofA guidelines, but not mandated by statute, rule, or policy.

Approximately 78 percent of the respondents to our agency survey said flexibility in pay administration was the main benefit of Pay Plan 20. This flexibility has a definite impact on the compensation philosophy of the state by changing from one of entitlement to one based on performance. This is discussed further in Chapter IV.

Conclusion: Pay Plan 20 provides more flexibility than Pay Plan 60, and state agency managers consider this flexibility a major benefit of Pay Plan 20. This flexibility will impact the compensation philosophy of the state.

Implementation of Pay Plan 20

When an agency decides to transition to Pay Plan 20, state policy requires the agency to develop an implementation proposal, or transition plan. DofA must evaluate the transition plan based on how well it adheres to its policy of “improving service to the public” and “expanding career opportunities for employees.” Once the plan is approved by DofA, an agency can transition to Pay Plan 20.

As of July 2006, 24 state entities had transitioned at least a portion of positions to Pay Plan 20. The following table provides a listing of the entities and the percentage of positions in the plan.

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Table 4
State Entity Participation in Pay Plan 20
 (as of July 2006)

Agency	Percentage of Positions
Administration	95.86%
Agriculture	0.00%
Arts Council	80.00%
Board of Public Education	25.00%
Commerce	95.53%
Commissioner of Higher Education	0.00%
Corrections	94.84%
Environmental Quality	98.97%
Fish, Wildlife and Parks	99.86%
Governor's Office	43.08%
Historical Society	2.86%
Justice	68.56%
Labor and Industry	99.00%
Livestock	14.71%
Military Affairs	94.64%
Natural Resources and Conservation	96.81%
Office of Public Instruction	91.14%
Political Practices	75.00%
Public Defender	83.16%
Pubic Health and Human Services	32.62%
Public Service Commission	52.63%
Revenue	4.18%
School for the Deaf and Blind	4.80%
Secretary of State	78.43%
State Auditor	0.00%
State Fund	0.00%
State Library	100.00%
Transportation	72.24%

Source: Compiled by the Legislative Audit Division from department records.

There are a couple of reasons for the variations in percentages of positions in Pay Plan 20 shown in the table above. One reason is that some positions are exempt from classification in a pay plan, so these positions are not included in the table. The other reason is some agency managers decided not to transition all employees to Pay Plan 20,

Chapter II – Implementation of Pay Plan 20

including agencies who have not transitioned any employees. As of July 2006, 7,745 positions in state government (63 percent) had transitioned to Pay Plan 20 (this excludes short-term, temporary, seasonal, and university employees). The percentage of employees in Pay Plan 20 is continually increasing as additional agencies transition to the alternative pay plan.

Pay Administration

According to DofA managers, general statutory compensation provisions (Title 2, chapter 18, part 3, MCA) do not apply to Pay Plan 20. The intent is to provide agencies with flexibility to pay employees for their competencies and accomplishments. Therefore, agencies may administer the procedures for using pay schedules differently than described in section 2-18-303, MCA.

According to a Department of Public Health and Human Services report on agency experiences with Pay Plan 20, nearly every agency implemented Pay Plan 20 by moving employees to a certain percent of market. While the market-based pay part of Pay Plan 20 is being implemented, most agencies have not yet implemented a performance-based system for employee movement within Pay Plan 20. Our survey indicates agencies have adjusted state employee pay under the following Pay Plan 20 components.

Table 5
Pay Plan 20 Components Implemented by State Agencies

Component	Agency															
	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P
Market	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Competency	✓	✓	✓			✓						✓	✓	✓	✓	
Performance		✓		✓								✓	✓			
Results	✓	✓			✓		✓		✓		✓					
Strategic	✓	✓	✓		✓			✓	✓	✓	✓					✓

Source: Compiled by the Legislative Audit Division from survey results.

Survey Opinions

We conducted a survey of human resource personnel in all Executive Branch agencies to obtain information and opinions on

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implementation of Pay Plan 20. The following table provides some of the information we obtained from our survey.

Table 6
Pay Plan 20 Survey Information
(Human Resource Personnel)

Question	Answer & Percentage	
What were the reasons for transitioning?	Flexibility in pay admin	78%
	Recruitment/Retention	70%
	Performance based pay	48%
	Market based pay	39%
What is the main reason for not transitioning?	Lack of resources (funding, FTE, etc)	67%
What percent of market were positions transitioned to?	95% to 100%	9%
	85% to 90%	50%
	75% to 80%	41%
What comprised costs associated with transition?	Certain percent of market	59%
	Minimum pay of band	50%
	Bonuses	14%
	Promotions	9%
How were costs funded?	Reallocation of budget	59%
	Vacancy savings	50%
	Attrition	41%
	State special revenue	18%
	Budget amendment	9%
Do you have recruitment and retention issues?	Yes	91%
	No	9%
Have recruitment/retention issues improved?	Yes	50%
	No	23%
	Do not know	23%
	Not applicable	4%
Do you believe Pay Plan 20 is a better pay plan?	Much better	54%
	Slightly better	36%
	Slightly worse	5%
	Much worse	5%
Why is Pay Plan 20 better?	Flexibility	95%
	Retention of employees	85%
	Competitiveness	80%
	Less pressure to reclassify	80%
	Higher pay	60%
Why is Pay Plan 20 worse?	Inequitable/Lack of regulations	100%
Do you believe desired outcomes were achieved?	Yes	24%
	Somewhat	48%
	No	9%
	Do not know	19%

Source: Compiled by the Legislative Audit Division from survey results.

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Conclusion: The majority of agencies and positions are in Pay Plan 20. Most agencies have focused on market-based pay. Pay administration is different between Pay Plan 20 and Pay Plan 60.

Impacts From Implementation of Pay Plan 20

While Pay Plan 20 is an alternative pay plan, the majority of state agencies are using it to compensate employees. Flexibility in pay administration is a significant change for the State of Montana, and this flexibility has an impact on the compensation philosophy of the state. First, the structure of Pay Plan 20 is based on comparable market salaries. DofA is responsible for administration of Pay Plan 20, which includes establishing market pay ranges based on Montana's competitive labor market. Chapter III discusses the process used by DofA to establish market-based pay ranges.

The second part of pay administration in Pay Plan 20 is performance-based pay. The plan provides agency managers flexibility to adjust employee pay based on various needs and accomplishments. However, there are several factors that impact the ability to succeed, and this element of Pay Plan 20 has not been fully realized. The final chapter provides information on the impacts Pay Plan 20 has on the state's compensation philosophy.

Chapter III – Establishing Pay Based on the Competitive Market

Market Analysis

The Department of Administration (DofA) is responsible for administering Pay Plan 20. One of the main activities conducted under this responsibility is market analysis. Market analysis is the collection and analysis of salary data from other employers for similar jobs. The results of the market analysis are used to establish market pay rates for specific occupations based on the competitive labor market.

Conclusion: Department Follows Common Practice

Overall, the State Personnel Division (SPD) market analysis process follows common industry practices used for establishing market pay rates. SPD staff collect, compile, and analyze salary data, and use the results of the analysis to establish occupational pay ranges for positions in Pay Plan 20. While the process does not include an in-depth analysis of the data such as examining benefits and the total compensation package, pay ranges are intended to only be an estimation of the Montana labor market.

Improvements to Process Should Help

One of our objectives was to determine if Pay Plan 20 pay rates established by DofA reflect market. We noted several areas where the process could be strengthened to help improve the establishment of market pay rates. These include defining Montana's competitive labor market, developing guidelines to help ensure consistency throughout the market analysis process, and approving all market pay rates. This chapter provides details supporting our findings and recommendations.

How Are Market Rates Set?

SPD personnel use three different surveys as sources of data to establish market rates for Pay Plan 20. These include:

- ▶ Occupational Employment Statistics (OES) – a mandated survey conducted by the U.S. Department of Labor & Statistics.
- ▶ Central States Compensation Association (CSCA) – a survey representing 25 state governments nationally, including survey data for the four surrounding state governments.
- ▶ Watson Wyatt (WW) – a private sector survey in which data must be purchased.

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These surveys provide compensation data for numerous occupations. The first step in the process is for SPD staff to make sure the data is comparable to Montana's state government occupations.

Job Matching

The data provided in the surveys shows the average compensation paid by various employers for defined occupations. SPD staff must match the survey data to Montana's state government occupations. Job matching is a critical part of the process. Jobs must be matched to appropriate survey data to ensure proper market-based compensation. The Standard Occupational Classification (SOC) system and the Occupational Information Network (O*Net) are used to classify positions by occupation.

The Bureau of Labor Statistics, U.S. Department of Labor, developed SOC for use in classifying workers into occupational categories for the purpose of collecting, calculating, and disseminating data. All workers are classified into one of over 800 occupations according to their occupational definition. O*Net is a comprehensive database of worker attributes and job characteristics. O*Net is used in addition to SOC as part of job matching, and is a primary source of occupational information that provides a common language for defining and describing occupations. O*Net is administered by the U.S. Department of Labor's Employment and Training Administration.

SPD staff compares descriptions of work to Pay Plan 20 classifications and uses education and experience ratings to determine the most likely match for each occupation. Other factors considered in applying survey data are Pay Plan 20 bands to which positions are allocated and the number of positions reported in the national salary surveys. This information is used to make sure each occupation is matched to the correct survey data.

Calculating Market Pay and Establishing Occupational Pay Ranges

The market data from the surveys is compiled for use in calculating a pay range for each classified occupation. In order to establish an occupational pay range, each occupation must be ranked according to Montana's classification system in order to place the occupation in

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the appropriate pay band. SPD staff uses education and experience as a basis for anchoring an occupation.

Once an anchor is established, the pay range for the occupation is calculated. Market rates are used as the midpoints in the development of pay ranges. A 20 percent midpoint progression is used for each occupation, and may include a pay band progression, as can be seen in the table below. There are two reasons for creating pay band progressions: 1) to establish a progression for promotions, and 2) salary survey data only has one survey data point. The resulting matrix provides the occupational pay ranges for use by agency management in setting pay for individual positions. The following figure shows an example of the occupational pay range for an accountant.

Table 7
Occupational Pay Range - Accountant

Pay Band	Minimum	Market	Maximum
5	\$27,059	\$33,823	\$40,588
6	\$32,470	\$40,588*	\$48,706
7	\$38,964	\$48,706	\$58,447

* Average wage calculated from salary survey data used as anchor point.

Source: Department of Administration.

Once finalized, the market analysis is posted to the DofA website for use by state agency personnel. See Appendix A for an example of a published market analysis. While the DofA process follows common practices, improvements could be made in how market rates are developed.

Conclusion: Overall, the market analysis process follows common industry practice for establishing market pay rates, and improvements could be made.

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Market Analysis Process Could Be Improved

During our review of the process, we identified several areas where we believe improvements could be made to further strengthen the market analysis process. The following sections summarize our findings.

Discounting Survey Data

As explained previously, DofA uses three sources of survey data to develop market pay rates. Two of these surveys represent all 50 states (national data), while the third represents 25 states. In order to approximate the relationship of Montana salaries to national salaries, the department's market analysis process includes an adjustment to the national survey data of 85 percent. DofA established this 15 percent discount factor using the relationship of Montana to the U.S. median wage from OES survey data. The following table provides an example of discounting for one occupation.

Table 8

Example of Survey Data Discounting

(Occupation – Accountant)

Survey Data Source	Actual	Discounted
CSCA Four State Govts.	\$36,248	
CSCA - 25 States Govts.	\$40,252	
OES MT	\$41,569	
Watson-Wyatt	\$48,546	\$41,264
OES US	\$51,300	\$43,605
Average		\$40,588

Source: Compiled by the Legislative Audit Division from department records.

Is Discounting Appropriate?

According to SPD, since the market analysis process seeks to estimate a Montana market rate, national survey averages are not used directly. Montana wage rates by occupation are typically much lower than the national average. Consequently, estimation of the Montana labor market using national data must take this difference

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into consideration. As a result, a general discount factor of 15 percent was developed.

SPD managers say human resource organizations commonly use discounting to make survey data better match a specific region. However, agency managers and state employees have a concern with the appropriateness of discounting survey data. Their concern is that survey data should speak for itself and should not be discounted. Based on our review, we believe the department should re-evaluate its discounting methodology to try to obtain better data. Discounting survey data is a way to adjust salary figures to more accurately reflect a regional market. However, documentation of the methodology used by DofA does not clearly indicate this discount provides the best and most accurate figure.

What Methodology Should be Used?

The department currently uses a general discount factor of 15 percent for all occupations based on where Montana ranks to the national median. In other words, every occupation is discounted to 85 percent of the national median market rate. However, the median ranking is also available for individual occupations, and the median percentages for individual occupations vary considerably. The following table provides examples of the median percentage of several occupations.

Table 9

Examples of Median Percentage of Market for Occupations
(Montana compared to the United States)

Occupation	Median Percentage
Computer Information Systems Manager	69%
Lawyer	56%
Fish, Wildlife and Parks Warden	No Data
Forester	99%
Range Management Specialist	95%

Source: Compiled by the Legislative Audit Division from department records.

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If the department used the factor associated with each occupation rather than a general discount factor, it could provide a more realistic market rate for each occupation. As can be seen in the previous table, some occupations do not have an associated median ranking. For these occupations, the department may want to use the general discount factor of 15 percent in order to maintain consistency in the market analysis process.

Why Does the Department Discount Survey Data?

According to SPD managers, the reason for discounting is to estimate a Montana market. The Watson Wyatt survey is national data from the private sector, which includes Fortune 500 firms and other national companies. They discount the data to approximate the relationship between Montana and national wages. The reason for discounting the national OES survey data is based on the reasoning discussed above. The CSCA and OES Montana survey data is not discounted because it is either state government wage information or State of Montana information. The department believes state government wages, as well as Montana wages, already lag the market, so they consider this data to be already discounted.

SPD management indicates concerns from various sources, including legislators and the Governor's Office, regarding higher costs for paying national wages, which led to discounting survey data. However, documentation does not validate the reasons for discounting, or that the 15 percent discount provides the best and most practical salary comparison. We believe the department should re-evaluate its current procedure of using a general discount factor, based on one survey source, to discount some of the survey data. The analysis should include a review of the appropriateness of using the general OES median percentage as the discount factor. Based on the results of its analysis, the department should modify its current discounting methodology or document the reasons for continuing to use a 15 percent discount. The results of the analysis should be incorporated into the market analysis methodology.

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Recommendation #1

We recommend the department re-evaluate its discounting procedure to determine if a better methodology can be used to calculate more practical market rates, and document and incorporate the results of the analysis into the market analysis process.

Competitive Labor Market

For compensation, the term market refers to the collective group of employers that compete for employees. So what is Montana State Government's competition? There is no one answer. It depends on the occupation. There is competition with other state governments, the federal government, and the private sector.

What is Montana's Competitive Market?

According to the Society for Human Resource Management, there are at least three factors that define the relevant labor market. Competition for employees occurs with shared industry (similar products or services), occupations (same experience or skills), and location (same geographical area). Statute, while limited for the alternative pay plan, does indicate intent for pay to be established based on the relevant labor market. However, Montana's relevant labor market is not defined in, rule or policy.

How Does DofA Define Montana's Market?

DofA considers salary data from the contiguous states of Idaho, North Dakota, South Dakota and Wyoming because of their proximity and comparable demographics. Like Montana, these four surrounding states have primarily rural economies with lower wages in relation to national averages. However, DofA documentation indicates recruitment for many Montana positions occurs in states such as Washington, Oregon, Nevada and Utah. There may be a difference between the survey data used to calculate market rates and Montana's competition. The data used may not directly match the competition, so it is not a relevant labor market. As a result, it is not known if Montana's pay rates are competitive with the relevant labor market.

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DofA developed its process without specifically defining market. Survey data that is readily available, commonly used, and lower in cost is used to set market rates. However, according to division management, more specific survey data is available, which may be more relevant to Montana's competitive labor market. The department should identify the relevant labor market and develop a definition based on current practices and input from state agency personnel.

Recommendation #2

We recommend the department identify and define the relevant labor market for Montana State Government.

Criteria to Guide the Process

While observing the SPD market analysis process, we noted staff regularly make decisions regarding use of salary survey data for calculating market rates. When asked how these decisions are made, we found no set criteria to guide the process. Decisions are judgment calls based on individual staff analysis. According to SPD personnel, data is thrown out if the analyst does not believe it is valid. There are no set criteria on when to use survey data and when to eliminate it from calculations. Staff said they consider other factors in the decision such as the source of the data, job titles, job descriptions, etc. However, the amount of the salary is what often triggers the decision-making process. If the salary is too high or too low, in the opinion of the individual staff member, its use is questioned.

Examples of Decision-Making

There are numerous decisions made regarding the market analysis process which lack criteria to help guide staff. This section provides some examples.

- ▶ One example of a decision made regarding the process relates to changing the market rate: using the current calculation or the previously published market rate. There are ups and downs in salary data from year to year. For the 2006 market analysis process, if the 2004 market rate was higher, staff used it instead

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of the new one. The reason stated was to avoid problems with individual pay needing adjustments and disparate impacts.

- ▶ The same action was taken for comparisons to Pay Plan 60 averages. If the current average salary paid to employees in Pay Plan 60 was higher than the calculated market rate, then the Pay Plan 60 average salary rate was used instead of the calculated market rate.
- ▶ A similar decision was made for use of OES data. SPD made a decision to use the higher of the two OES markets: the actual OES Montana salary figure or the OES Montana salary data minus state government. The reason for this is that Montana state government salary data may lower the average of the OES Montana reported wages.

Other decisions were made based on factors such as the relative standard error rate of survey data, including salary data in calculations that would normally not be included because of job matching, and bargained salary ranges. While SPD personnel indicate a desire to publish markets as they are, they make decisions to change salary data.

Consistency of Decision-Making is Impacted

SPD personnel set market rates for over 400 occupations, so it is important to have formal guidelines to help ensure consistent decision-making in calculating market rates. Managers recognized a need for consistency when they implemented a group discussion as part of the process. However, there are no guidelines to help ensure differences in decision-making are not encountered.

What Can Be Done About It?

The market analysis process is relatively new, and SPD continues to modify it to try to improve it. At the same time, SPD tries to minimize changes from one biennium to the next to help maintain consistency. SPD says the process is not an exact science, nor is it completely objective. They must exercise discretion, so they do not believe a single standardized approach can be applied to determine market rates. There is resistance to establishing standards due to the number of and variations in occupations.

While some judgment needs to be applied, formal guidelines are needed to help ensure consistency in similar situations. Certain

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standards are already being informally used during the process. For example, SPD staff review the relative standard error (RSE) rate of salary survey data. According to SPD management, they established an RSE of 1.5 percent or above as excessive, but staff does not have documented guidance to help direct decision-making. As a result, SPD personnel are not using specific, formalized guidelines to base decisions on.

In order to ensure consistency between analysts, as well as from year to year, DofA should develop formal guidelines for decision-making. DofA could incorporate guidelines into current analysis tools to help identify anomalies for use during group discussions and finalization of markets. This should help increase the consistency and objectiveness of market rate development from analyst to analyst and year to year.

Recommendation #3

We recommend the department develop and document formal guidelines for use by staff in analyzing and establishing occupational markets.

Market Analysis by Other Entities

While most agencies adopt market rates established by DofA, there are some occupations in which market rates are established by another entity. In addition, one agency chooses not to adopt DofA market rates, and instead establishes its own. If salary data is not available in the surveys used by DofA, a market is not established for the occupation. An agency employing these unique occupations must establish its own salary ranges. Depending on the agency, this may be accomplished by conducting its own salary survey, hiring a private contractor to conduct a salary survey, or working with DofA to establish market rates. There is no policy regarding how market rates should be established for unique occupations, and how the process should be conducted when this occurs.

According to statute (2-18-301, MCA), it is the intent of the legislature that compensation plans for state employees be based on

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an analysis of the labor market as provided by DofA. In addition, the department is given responsibility to develop and implement an alternative pay plan; including establishing and changing pay for employees based on, among other things, the labor market. By allowing other agencies to develop market rates, DofA has not fully implemented statutory intent.

Inconsistency Leads to Inequity

Use of different procedures by different agencies to establish market rates could create inconsistencies, which could lead to inequities. While a unique position within one agency will not create an inequity with another agency, if market rates are not established in a similar manner, the equity of occupational pay rates in the compensation system will be jeopardized.

While the majority of agencies adopt DofA market rates, a few agencies do not. In most cases, individual agency personnel have more detailed knowledge of the requirements needed for specific occupations. As such, it makes sense that these individuals be involved in establishing market rates. However, DofA is statutorily charged with administration of pay plans. Development of market rates by several agencies creates a disjointed system. The result is lack of a state administrator of Pay Plan 20.

DofA has not required all agencies to adopt its markets, and has not developed detailed guidance on what form other agency markets should take, and how these markets will be approved. In order to fully implement the intent of the law, DofA needs to approve the market analysis for all occupations. This should include development of guidelines for agencies to follow when developing markets, including the DofA approval process, as well as posting all occupational rates to the DofA website. This will help increase consistency in establishing market rates and ensure the integrity of the compensation system.

Recommendation #4

We recommend the department approve market rates for all occupations.

Chapter IV – Montana’s Compensation System is Changing

Introduction

The legislature adopted the first uniform wage and salary plan for state employees in 1975. Since that time, there have been several changes to Montana’s compensation system trying to address recruitment and retention issues, as well as moving toward competitive market pay. The 1999 Legislature enacted legislation directing the Department of Administration (DofA) to develop and implement an alternative pay plan for Montana state government employees. Since this initial directive, state employees have been transitioning to the alternative pay plan (Pay Plan 20), and currently the majority of state employees are in Pay Plan 20.

The Compensation System is Changing

The Director of DofA commissioned the State Pay Special Task Force to review the state’s compensation system to identify an affordable and equitable pay plan for state employees and define a pay philosophy. The Task Force met over several months and developed a vision, goals, and objectives document (see Appendix B). As a result, DofA plans to seek legislation to establish Pay Plan 20 as the state’s main compensation system and move all employees to the new pay plan by July 1, 2007.

This proposed change in pay plans is a significant change in compensation philosophy and organization culture. Pay for employees in Pay Plan 20 may be established and changed based on demonstrated competencies and accomplishments, on the labor market, and on other situations. In order to make an informed decision, the legislature needs all available information. There are some key questions the legislature should consider during its review of Pay Plan 20:

- ▶ Should the State of Montana move to a single pay plan?
- ▶ How important is market-based pay?
- ▶ Should Montana lead, match, or lag the market?
- ▶ Can the state afford to pay market-based salaries?
- ▶ Should the appropriation for employee pay be re-structured?

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- ▶ Should variations in pay for similar occupations be allowed?
- ▶ How important is individual performance and flexibility for pay increases?
- ▶ What is the best way to maintain internal equity?
- ▶ Does flexibility outweigh the need for standardization?
- ▶ How will the appropriation and budgeting process change?
- ▶ What outcomes are being achieved?

This chapter provides details in relation to these questions.

Pay Plan Variations

As of July 2006, 63 percent of state positions were transitioned to Pay Plan 20. DofA encourages use of market-based pay which is defined as pay based on how other employers compensate employees in similar positions. DofA also encourages agencies to integrate competency-, performance-, and results-based pay components into their human resource systems. While use of all Pay Plan 20 components is encouraged, most agencies are restricted on the degree of implementation based on available funding. All agencies in Pay Plan 20 use market-based pay and set salaries at a certain percent of market, depending on funding. For some agencies, this was the focus of implementing Pay Plan 20 (see Table 5, page 16). Other agencies are able to implement a compensation system allowing employees to move horizontally within their occupational pay range based on individual contributions.

Differences in Pay for Similar Occupations

DofA sets a minimum, market, and maximum pay rate for each occupation. However, individual employee pay is up to the discretion of agency management. This flexibility allows agency managers to use pay to recruit, retain, and reward employees for performance, competencies, and achievements. With no specific guidance and variations in available funding, individual employees in Pay Plan 20, hired for the same occupation but in different agencies, can and do get paid varying amounts within occupational pay ranges.

Transition Costs

The perception of some state employees is that everyone will get a raise when an agency transitions to Pay Plan 20. This is not

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necessarily the case; however, there are usually costs associated with transition to Pay Plan 20. Based on our survey of state agencies, costs to transition ranged from \$5,000 for 4 employees to \$1.8 million for 1,416 employees, while some agencies did not know what the cost was. Of those agencies that have transitioned to Pay Plan 20, a majority (59 percent) say there are transition costs in moving employees to a certain percent of market. Survey results indicate 77 percent of agencies have established salaries based on 75-85 percent of market, and 23 percent are paying 90-100 percent of market. Another cost related to moving to market-based pay is paying employees the minimum of the occupational pay range.

Agencies must pay for costs associated with transition from existing funding sources. There is currently no funding allocation to cover agency costs for transition to Pay Plan 20 or for pay administration once transition is complete. As a result, agencies pay for these costs through reallocation of existing budgets, attrition, and vacancy savings.

The transition of employees to Pay Plan 20 has created differences in pay for similar occupations. The following table illustrates an example of the range of differences for three state agencies and two different positions.

Table 10
Example of Entry Pay Differences at Transition

Agency	Entry Rate of Pay (% of market)	Human Resource Specialist (Band 6) Entry Pay	Administrative Assistant (Band 3) Entry Pay
DLI	95%	\$ 39,677.70	\$ 23,812.70
FWP	85%	\$ 35,501.10	\$ 21,306.10
DofA	75%	\$ 31,324.50	\$ 18,799.50
Largest Difference		\$ 8,353.20	\$ 5,013.20

Source: Compiled by the Legislative Audit Division from survey results and department records.

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Excluding any pay for performance components, the likelihood of pay inequities is greater. In the example illustrated in Table 10, there is a more than \$8,000 difference in annual entry pay for the same occupation between two different agencies. The result of differences in pay is competition between agencies. Agency personnel indicate employees are “lured away” by other state agencies paying higher wages, and that smaller agencies cannot compete with larger agencies that have more funding and/or different funding sources. If one agency pays 85 percent of market, but other agencies pay 96 percent of market, the lower paying agency may lose employees to other agencies entirely due to pay. Recruitment is also impacted because agencies advertise and hire at different salary rates for similar occupations. This competition also exists for agencies in other pay plans, such as Pay Plan 60. Salary rates for other pay plans administered by DofA, in general, are lower than those in Pay Plan 20. In addition, other pay plans have less flexibility with pay administration.

Conclusion: Pay plan variations among state agencies have created differences in pay.

Cultural Change

Historically, pay administration in Montana state government has tried to ensure “internal equity.” Internal equity is described as a person with the same knowledge, skills, and abilities in one department being paid the same as someone with the same knowledge, skills, and abilities in another agency for the same occupation. According to human resource organizations, an organization cannot effectively recruit new employees or retain existing ones without internal equity. Employees need fairness between what they bring to the agency in terms of education, experience, productivity, and other skills, and how the agency rewards them. Having internal equity helps the employer recognize employees’ contributions to the organization and reward equal work with equal pay.

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Equity, or fairness, may be interpreted differently by different individuals. What is fair and equitable to one person may seem inequitable to others. Table 10 (page 33) provides examples of variations in pay for similar occupations. On one hand, this situation could be viewed as simply a consequence of the system. On the other hand, it could be interpreted as an inequity.

Pay Plan 20 represents a major change in compensation philosophy and organizational culture. From an organizational standpoint, the change can be characterized as a move from one of entitlement (everyone gets any pay increase) to one based on performance (employees who perform get pay increases). In the past, if the legislature approved a pay increase, all employees received the increase, with the exception of employees who were paid at the maximum of their pay grade. With Pay Plan 20, agency managers can approve pay increases for individual employees. This is a significant change in how state employees are used to receiving pay increases, which is a change in the culture of pay administration for the State of Montana.

Flexibility Versus Standardization

A benefit of Pay Plan 20 is flexibility, and currently, laws directly related to this pay plan are limited. According to statute, pay for employees may be established and changed based on demonstrated competencies and accomplishments, on the labor market, and on other situations defined by DofA. On the other hand, Pay Plan 60 has various statutory requirements including pay schedules, minimum pay levels, and base salary increases. Agency managers indicate Pay Plan 60 laws do not apply to Pay Plan 20 operations, yet some of these laws are followed. For example, across-the-board increases appropriated by the legislature under Pay Plan 60, to date have been distributed to all employees under Pay Plan 20. As a result, it is not clear which laws apply to Pay Plan 20.

Managers have more flexibility in setting pay for individual employees based on market trends and performance. Employees have more flexibility in individual development and career progression. According to DofA, another benefit is a reduction in

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administrative costs due to simplifying classification, which saves time and resources for management and human resources staff. All this flexibility could be viewed as a lack of standardization. DofA has only developed general guidance, so each state agency is developing its own policies under Pay Plan 20. As a result, there are variations in the compensation system, such as how employees are paid in comparison to the competitive market, and if employees have opportunities for individual pay increases.

Market-Based Pay

As defined in the previous chapter, the term market refers to the collective group of employers with whom a company competes for employees. There are three possibilities regarding compensation in relation to the competitive labor market. An organization can: 1) lead the market by paying higher salaries, 2) match the market by paying about the same wages, or 3) lag the market by paying rates below other organizations. Matching the market is sometimes referred to as being externally competitive.

According to human resource sources, with market-based pay, as the competitive market fluctuates, so should employee pay. For example, if an organization is paying 100 percent of market and the market increases by 10 percent, there should be a corresponding increase in employee pay. In a traditional broadbanding salary system, as with Pay Plan 20, the midpoint of a pay range corresponds to the market salary for the occupation. The goal is to pay employees at midpoint when they are fully skilled and meet performance expectations. At that point, the employees’ salary is competitive with workers in similar job markets.

Performance-Based Pay

Aside from comparison to market rates, performance-based pay is a main component of broadbanding. While Montana’s state agencies are not required to implement a performance-based pay component as part of Pay Plan 20, some have done so or have plans to implement this component in the future (see Table 5, page 16). Broadbanding focuses more on horizontal progression within an occupational pay range, as opposed to vertical movement to a higher band. This de-emphasizes the need for reclassification to achieve

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higher pay. The emphasis of performance-based pay is to motivate employees to work to reach higher performance levels.

By granting managers and supervisors more discretion to determine pay increases, pay for performance increases responsibility for supervision. For example, supervisors must treat employees fairly in terms of the assignment of work, evaluation of performance, and allocation of rewards; and they must be held accountable for their decisions. This may include linking supervisors’ pay to how well they perform these duties, among their other responsibilities.

Nationally, human resource personnel emphasize the following core elements for successful implementation of performance-based pay:

- ▶ Clear connection and linkage between organizational goals and individual performance expectations within an overall performance management system.
- ▶ Top-level management support and employee involvement.
- ▶ A fair and transparent performance appraisal system applied consistently across the organization.
- ▶ Meaningful rewards for good performers.
- ▶ Development and training for poor performers.
- ▶ Holding managers accountable for performance-based management.

Conclusion: The concept of broadbanding is a major change in compensation philosophy and organizational culture for the State of Montana.

What Outcomes Are Being Achieved?

Pay Plan 20 is considered the state’s alternative pay plan, but the majority of state agencies are using it. Since Montana’s compensation system is changing, what outcomes are being achieved as a result? The idea behind creation of the alternative pay plan was to address recruitment and retention issues by providing agency managers with tools to better fit individual agency needs. The system provides more authority and flexibility to agency managers, provides greater emphasis on the labor market, and simplifies the

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process. By replacing grades with open salary bands, employers can better respond to market trends, offer more attractive starting salaries commensurate with an individual’s qualifications, and reward employee performance. In general, these are desired outcomes of any broadband system.

Desired Outcomes Are Not Measured

Another desired outcome of a broadband system is improved organizational performance. Providing flexibility and basing pay on the competitive markets should increase employee moral and productivity, which in turn should positively impact the organization’s operations. It has been more than five years since state agencies started transitioning to Pay Plan 20. However, there is no information available indicating whether the alternative pay plan is achieving desired outcomes. Resources and information on pay systems indicate effective implementation includes an ongoing review of the system.

DofA requires an agency to complete an implementation proposal prior to transitioning to Pay Plan 20. The proposal lists the business reasons for wanting to transition, such as organizational and individual performance issues the agency wants to address. Our survey of state agencies indicates the majority of agencies transitioned to Pay Plan 20 for flexibility in administering pay, as well as recruitment and retention of employees. Our survey results indicate 90 percent of agencies in Pay Plan 20 have recruitment and retention problems. However, only 50 percent said implementation of Pay Plan 20 has reduced recruitment and retention issues.

Recruitment and Retention Issues

According to a DofA report, the turnover rate (left state government employment) for calendar year 2005 was 11.8 percent, and less than 1 percent (10 of 1,426) left because of compensation. This statistic may not be an exact representation because agencies are not required to submit turnover information and there are numerous reasons for leaving employment that could be submitted inconsistently. When asked how agencies measure improvement in recruitment and retention, a majority of respondents stated they look at the number of qualified applicants and agency turnover rates. For example, one

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agency indicated it has experienced a 50 percent drop in applicants for a specific occupation, as well as a decrease in the quality of applicants based on abilities observed during probationary periods. Another agency indicated it compiles statistics on turnover, but it has yet to analyze results. We reviewed some examples of turnover statistics and found variances in form and content. In addition, we did not identify any documentation related to recruitment. While agencies are aware of recruitment and retention, not all agencies gather statistics or analyze data on an ongoing basis. Ongoing monitoring cannot occur without statistics and analysis.

There is no requirement to track and monitor recruitment and retention, employee productivity, or other aspects related to outcomes associated with a pay plan. As a result, each agency is left to its own devices on whether or not to monitor operations. In order to determine the impacts of Pay Plan 20, outcomes should be tracked and monitored. This information will enable the legislature and DofA to make informed decisions regarding operation of the alternative pay plan.

Recommendation #5

We recommend the department establish a system for compiling and monitoring recruitment and retention data, and other aspects related to Pay Plan 20.

Appendix A

MARKET ANALYSIS BROADBAND PAY PLAN ACCOUNTANT

Reviewed: April 2006

Note: This market analyses is **not** meant to be a “stand alone” document. Users can find explanatory documents in the *!ReadMe* Directory on the MINE intranet site under *Market Analyses by Class*. These explain the intended use of market analyses and how the information and analyses were produced.

SOC: Accountants and Auditors

13-2011

O*Net: Accountants

13-2011.01

Current Broadband Plan Classes:

Job Code	Class Title	Pay Band
132115	Accountant	05
132116	Accountant	06
132117	Accountant	07

I. SUMMARY ANALYSIS

Classification level 6 is used for applying survey data and for extending survey rates to other levels in the class series (see section III). The following table shows survey data considered in determining a market rate. Details on survey data are provided in sections IV–VI of this document.

Summary Survey Data Accountant - Level 6 Median Data		
Survey Data Source	Non-adjusted	Adjusted .85
CSCA Four State Govts.	\$36,248	
CSCA - 25 States Govts.	\$40,252	
OES MT	\$41,569	
Watson-Wyatt	\$48,546	\$41,264
OES US	\$51,300	\$43,605
Average		\$40,588

Absent a more in-depth study of job matching, total compensation and rewards, and other variables in relation to each survey source, a reasonable market rate appears to be **\$40,588**. This amount is the average of the CSCA Four States Governments, CSCA - 25 States Governments, OES MT, and OES US and Watson-Wyatt adjusted national rates.

Appendix A

The following table shows pay ranges based on a **\$40,588** market rate at level 6, a 20% midpoint progression, and a 50% range width. (Note: ECS data shows an average 55% range width.)

Pay Band	Minimum	Market	Maximum
5	\$27,059	\$33,823	\$40,588
6	\$32,470	\$40,588	\$48,706
7	\$38,964	\$48,706	\$58,447

II. OCCUPATIONAL CLASS STANDARDS

Positions with this title are classified using O*Net standards (Occupational Information System). These standards are copied below for immediate reference. All tasks and conditions listed in the O*Net summary description and task list need not apply to the position being classified for the class to be considered an appropriate match. Additional information such as Skills, Knowledge, Abilities, Interests, Work Values, Work Context, and Work Activities for this occupational title can be found on the O*Net web site at: <http://online.onetcenter.org/link/summary/13-2011.01>.

Summary Report for: 13-2011.01 - Accountants

Analyze financial information and prepare financial reports to determine or maintain record of assets, liabilities, profit and loss, tax liability, or other financial activities within an organization.

Tasks

- Prepare, examine, and analyze accounting records, financial statements, and other financial reports to assess accuracy, completeness, and conformance to reporting and procedural standards.
- Compute taxes owed and prepare tax returns, ensuring compliance with payment, reporting and other tax requirements.
- Analyze business operations, trends, costs, revenues, financial commitments, and obligations, to project future revenues and expenses or to provide advice.
- Report to management regarding the finances of establishment.
- Establish tables of accounts, and assign entries to proper accounts.

Develop, maintain, and analyze budgets, preparing periodic reports that compare budgeted costs to actual costs.
- Develop, implement, modify, and document recordkeeping and accounting systems, making use of current computer technology.
- Prepare forms and manuals for accounting and bookkeeping personnel, and direct their work activities.
- Survey operations to ascertain accounting needs and to recommend, develop, and maintain solutions to business and financial problems.

- Work as Internal Revenue Service agents.

For more detailed task information go to: <http://online.onetcenter.org/link/details/13-2011.01>

III. CHOOSING THE CLASSIFICATION LEVEL FOR APPLYING SURVEY DATA

Classification Level 6 has been chosen as the appropriate level for applying survey data for this class based on a comparison to BLS and O*Net ratings. These ratings as shown in the following tables are comparable to the typical education and experience parameters for classification level 6.

Classification Level Six

Work involves the application of the principles and practices of a professional field to diverse assignments in which conflict situations, ambiguous concepts or divergent views are typical. Work requires developing policies, new methods or techniques to resolve sensitive problems through individualized solutions to recurring problems or situations, based on data that is complicated and intricate. Plans or designs must be oriented to complex or uncommon sites, circumstances or natural resource features. Plans and approaches are based upon extensive information, or numerous variables and include determining the relative importance, and value of the data or variables. Modification and testing applications of known and accepted processes to new applications involves diverse parameters and work includes testing for soundness of approach. Work requires demonstrated skill and professional knowledge of a breadth of issues associated with an occupation applicable to complex and/or diverse assignments.

Typical Education and Experience:

The required knowledge and skills are typically acquired through the completion of a Bachelor degree and 2-5 years related experience, or Master degree and 0-3 years experience, or a Juris Doctorate degree and 0-2 years of experience.

Job Zone

Title Job Zone Four: Considerable Preparation Needed

Overall Experience A minimum of two to four years of work-related skill, knowledge, or experience is needed for these occupations. For example, an accountant must complete four years of college and work for several years in accounting to be considered qualified.

Job Training Employees in these occupations usually need several years of work-related experience, on-the-job training, and/or vocational training.

Job Zone Examples Many of these occupations involve coordinating, supervising, managing, or training others. Examples include accountants, chefs and head cooks, computer programmers, historians, pharmacists, and police detectives.

SVP Range (7.0 to < 8.0)

Education Most of these occupations require a four - year bachelor's degree, but some do not.

Appendix A

Bureau of Labor Statistics (BLS)	
OEP Education/Training Categories	Code
Bachelor's degree: at least 4 years but not more than 5 years FTE academic work	5

For this occupation, Job Zone 4 is a close match with the above BLS Code.

IV. 2004 OCCUPATIONAL EMPLOYMENT STATISTICS SURVEY (OES)

Description: Examine, analyze, and interpret accounting records for the purpose of giving advice or preparing statements. Install or advise on systems of recording costs or other financial and budgetary data.

Wages: ACCOUNTANTS AND AUDITORS

Location	Pay Period	2004				
		10%	25%	Median	75%	90%
United States	Hourly	\$15.71	\$19.35	\$24.67	\$32.41	\$42.63
	Yearly	\$32,700	\$40,200	\$51,300	\$67,400	\$88,700
Montana	Hourly	\$13.71	\$15.83	\$19.68	\$25.46	\$34.48
	Yearly	\$28,500	\$32,900	\$40,900	\$53,000	\$71,700

The Montana median is .80 of the national median and ranks 46th in the nation. Montana wages for most occupations are significantly lower than national wages.

Montana state government salary data has in many cases a significant impact on MT OES reported wages. MT OES data for this title without state government is reported in the following table. Since state government's analysis of the MT market should be the remainder of the MT market absent state government, the rate from the following table **may be** used in determining a market rate.

OES MT - No State Government Data Included		
SOC #	SOC Title	Median
13-2011	Accountants and Auditors	41,569

V. CSCA SURVEY 2005

2110 ACCOUNTANT - This is responsible journey level professional accounting work requiring the exercise of judgment in applying established accounting procedures and regulations in maintaining financial records, checking for accuracy of accounts or other financial records, gathering data prior to budget preparation and composing reports. Reports are reviewed for accuracy and conformance to departmental policy.

Since this survey benchmark is described as a journey level accountant, it is matched to classification level 6.

Number	Match Title	# Inc	Average	CSCA 25 States Median	State
2110	Financial Specialist	53	37,325		ID
2110	Acct/Budget Specialist II (0222)	18	33,885		ND
2110	Accountant	26	32,510		SD
2110	Financial/Statistical Specialist 4 (FS04B)	60	34,736		WY
	AVERAGE		36,248	40,252	
2110	Accountant	51	42,786		MT

VI. WATSON-WYATT SURVEY 2005

Description

0300 Accountant

Global Grade(s): 9-13

Prepares income and balance sheet statements, consolidated statements, and various other accounting statements and reports. Analyzes financial reports and records, making recommendations relative to the accounting of reserves, assets, and expenditures. Reviews and verifies the accuracy of journal entries and accounting classifications assigned to various records. Conducts special studies and develops or recommends accounting methods and procedures. Instructs or assigns work to bookkeepers and accounting clerks engaged in general accounting activities. Coordinates accounting matters with other departments, locations and divisions. Utilizes computer to input, retrieve or display accounting information. See Level Guide PROF4.

Level Guide PROF4

LEVEL	EXPERIENCE	KNOWLEDGE	RESPONSIBILITIES	USUALLY REPORTS TO
1 Entry	0-2 years professional experience. Entry level for employees with Bachelor's Degree or equivalent. OR For legal positions, those with JD or LL.B. or equivalent	Knows fundamental concepts, practices and procedures of particular field of specialization.	Using established procedures and working under immediate supervision, performs assigned tasks. Work is routine and instructions are usually detailed. Little evaluation, originality or ingenuity is required. For legal positions may prepare briefs and documents to draw up contracts for review and evaluation by others.	Lead Level
2 Inter-mediate	2-5 years professional experience.	Knows and applies the fundamental concepts, practices and procedures of particular field of specialization.	Under supervision, performs work that is varied and that may be somewhat difficult in character, but usually involves limited responsibility. Some evaluation, originality or ingenuity is required.	Lead Level

Appendix A

LEVEL	EXPERIENCE	KNOWLEDGE	RESPONSIBILITIES	USUALLY REPORTS TO
3 Senior	5 - 8 years of professional experience. Fully competent professional - the first career level in the ladder (i.e., it is expected that all competent professionals will reach this level).	Possesses and applies a broad knowledge of principles, practices, and procedures of particular field of specialization to the completion of difficult assignments. For legal positions specializes in a particular area, such as litigation, tax, patent, etc.	Usually works with minimum supervision, conferring with superior on unusual matters. May be assisted by Entry or Intermediate Level personnel. Assignments are broad in nature, usually requiring originality and ingenuity. Has appreciable latitude for unreviewed action or decision. For legal positions acts in advisory capacity, making recommendations which may have an important bearing on the conduct of the organization's business.	Lead Level or Middle Management
4 Lead	More than 8 years professional experience. Management is typically the next higher level.	Possesses and applies comprehensive knowledge of particular field of specialization to the completion of complex assignments. For legal positions, is fully qualified in a particular area, such as in litigation, tax, patent, etc.	Under general supervision, plans, conducts and supervises assignments. Reviews progress and evaluates results. In legal settings conducts and supervises broad legal assignments, necessitating ability to evaluate matters which may have a major bearing on the conduct of the organization's business. Plans and assigns personnel for given projects or tasks. Assists with the review and evaluation of personnel performance. Interprets and applies organization policy. Recommends changes in procedures. Operates with substantial latitude for unreviewed action or decision. Reviews progress with management.	Upper Middle Management or Top Management

A combination of Watson-Wyatt levels 2 and 3 in this guide has been interpreted as equivalent to the broadband classification level 6. The combined median salaries of levels 2 and 3 are **\$48,546**.

Appendix B

June 13, 2006

VISION

The State of Montana attracts, retains and motivates a high-quality workforce.

GOALS & OBJECTIVES

The following goals and objectives apply to all executive branch positions covered under 2-18-101 through 2-18-320, MCA, except those covered under the collectively-bargained blue collar plan. Specifically, the proposal includes all executive branch employees who are not elected officials or the personal staff of elected officials. It excludes employees of the university system, employees of Montana's legislative and judicial branches, and all other positions listed under 2-18-103, MCA.

- 1. *The State's compensation system¹ will be internally equitable.***
 - (a) The compensation system will rely on a single classification plan by July 1, 2007; the plan will use job-related standards that are uniform and consistently applied.
 - (b) The compensation system will rely on the same centrally-established market rates and pay ranges for the same job classes within each pay band.
 - (c) The compensation system will not discriminate against women or minorities.
 - (d) The Office of Budget and Program Planning will work with state agencies to develop a transitional funding approach to mitigate pay differences between employees in agencies with varying funding resources.

- 2. *The State's compensation system will be externally competitive.***
 - (a) All state agencies will move to the broadband pay plan by July 1, 2007.
 - (b) The Department of Administration will survey competing employers biennially to set pay band levels, identify current and accurate market rates for all occupations, and compare other employers' benefit packages. Representatives of state agencies will participate in the survey process to ensure survey job matches are valid and reliable.
 - (c) The long-term goal of Montana state government is to compete for qualified workers by paying the market rate at hire for all state jobs. Given fiscal constraints, however, the shorter term goal will be to pay all employees a minimum of 85 percent of market.
 - (d) The Department of Administration will work with state agencies to develop strategic recruitment, retention and succession plans for specialized, difficult-to-recruit occupations and management positions.

¹ The state's compensation system includes three components – the pay plan, the classification plan, and the benefits plan.

Appendix B

3. *The State's compensation system will be fiscally responsible.*
 - (a) State agencies will implement pay plans that are financially sustainable.
 - (b) State agencies will tie employee performance expectations to their agency missions.
 - (c) State agencies will actively manage the performance of employees to ensure agency missions are met.

4. *The State's compensation system will be flexible, recognizing employees' individual contributions.*
 - (a) State agencies will design their own pay plan rules within the broad parameters established through these goals and objectives.
 - (b) State agencies will design and implement strategic human resource activities (recruitment, training, retention, and succession management) to meet emerging workforce challenges and respond to labor market realities.
 - (c) State agencies will identify, acknowledge, and may reward employees for their competencies and performance.
 - (d) The State Office of Labor Relations will negotiate with state employee labor unions the parameters of the single compensation system, and will bargain agency pay plan rules with labor unions representing the respective agency employees.

5. *The State's compensation system will be supported by the Department of Administration.*
 - (a) The Department of Administration will support agencies by analyzing and identifying best practices, providing current and accurate occupational market rates, assisting agencies implementing and maintaining their pay and workforce development plans, and reviewing and approving agency pay plan rules.
 - (b) The Department of Administration will help state agencies ensure their pay practices do not have a disparate impact on women or minorities.
 - (c) The Department of Administration will assist agencies in the fair and equitable application of the classification and pay plans across all agencies.

6. *The compensation system will be easily understood and communicated to all stakeholders.*
 - (a) The Department of Administration will develop a communications plan for state workers, state employee unions, and the legislature describing in plain and concise terms the compensation system and corresponding changes in management practices.
 - (b) State agencies will communicate to employees, in plain and concise terms, the specifics of their agency plans, the effect on each employee's pay rate, and any corresponding changes in agency expectations and management practices.
 - (c) The Department of Administration will assist state agencies to educate agency managers responsible for administering the pay plan.

Department Response

DEPARTMENT OF ADMINISTRATION
DIRECTOR'S OFFICE



BRIAN SCHWEITZER, GOVERNOR

JANET R. KELLY, DIRECTOR

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November 6, 2006

Jim Pellegrini
Deputy Legislative Auditor
Legislative Audit Division
P.O. Box 201705
Helena, MT 59601

RECEIVED

NOV 06 2006

LEGISLATIVE AUDIT DIV.

Dear Mr. Pellegrini:

The Department of Administration has reviewed the November 2006 Pay Plan 20: The State's Alternative Pay Plan Performance Audit Report, and the recommendations contained therein. Our response to the recommendations appears below.

We have also attached a Corrective Action Plan per the requirements of Management Memo #2-05-2.

Recommendation #1

We recommend the department re-evaluate its discounting procedure to determine if a better methodology can be used to calculate more realistic market rates, and document and incorporate the results of the analysis into the market analysis process.

Response:

We concur. The department will involve senior management representatives in evaluating its current discounting procedure to determine if a better method exists to calculate market rates. The department will use acceptable industry standards to establish market rates if discounting is used.

Recommendation #2

We recommend the department identify and define the relevant labor market for Montana State Government.

Response:

We concur. The department will include state agencies in its efforts to identify and define the relevant labor market for Montana State Government.

Recommendation #3

We recommend the department develop and document formal guidelines for use by staff in analyzing and establishing occupational markets.

Response:

We concur. The department will formalize existing guides and publish general guidelines for establishing occupational markets.

Recommendation #4

We recommend the department approve market rates for all occupations.

Response:

We concur. The department will approve market rates for all occupations.

Recommendation #5

We recommend the department develop a system for compiling and monitoring recruitment and retention data, and other aspects related to Pay Plan 20.

Response:

We concur. The department will identify relevant metrics to measure the effectiveness of the broadband pay plan in meeting agency needs related to the recruitment and retention of a qualified workforce.

Thank you and your staff for conducting the audit in a professional manner.

Sincerely,



Janet R. Kelly, Director

Attachment

CORRECTIVE ACTION PLAN: PERFORMANCE AUDIT PAY PLAN 20
Department of Administration
November 6, 2006

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Agency	Audit Report & Rec #	Does this affect a federal program?	CFDA # (if previous YES)	Management View	CAP – Corrective Action Plan	Person responsible for CAP	Target Date
61010	06P-06 #1 Step 1	No		Concur	Develop task force to research & develop a discounting methodology	Lynn Long	06/30/07
61010	06P-06 #1 Step 2	No		Concur	Publish new methodology	Lynn Long	11/30/07
61010	06P-06 #1 Step 3	No		Concur	Use methodology in 2008 market process	Lynn Long	01/01/08
61010	06P-06 #2 Step 1	No		Concur	Develop task force to define the relevant labor market	Lynn Long	06/30/07
61010	06P-06 #2 Step 2			Concur	Publish labor market and train agencies	Lynn Long	09/01/07- 12/30/07
61010	06P-06 #2 Step 3			Concur	Use methodology in 2008 market process	Lynn Long	01/01/08
61010	06P-06 #3	No		Concur	Develop general guidelines for market analysis process	Lynn Long	1/02/08

61010	06P-06 #4 Step 1	No			Concur	Develop policy or administrative rule for approval process with state agencies	Randy Morris/ Lynn Long	7/30/07
61010	06P-06 #4 Step 2	No			Concur	Provide assistance to agencies developing markets	Randy Morris/ Lynn Long	9/30/07- 12/30/07
61010	06P-06 #4 Step 3	No			Concur	Approve all market rates	Randy Morris	03/30/08
61010	06P-06 #5 Step 1	No			Concur	Develop metrics to measure recruitment and retention with state agencies	Lynn Long	09/01/07
61010	06P-06 #5 Step 2	No			Concur	Provide training to agencies in using metrics	Randy Morris/ Lynn Long	10/1/07- 05/01/08
61010	06P-06 #5 Step 3	No			Concur	Agencies report of metrics and SPD monitors data	Randy Morris/ Lynn Long	07/01/08