LEGISLATIVE AUDIT DIVISION

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MEMORANDUM

TO: Legislative Audit Committee Members

FROM: Angie Grove, Deputy Legislative Auditor, Performance Audits

CC: Janet R. Kelly, Director, Department of Administration
Paula Stoll, Acting Administrator, State Human Resources Division
Peggy Davis, Chief, Human Resources Policy and Programs Bureau

DATE: September 2008

RE: Performance Audit Follow-up 08SP-19: Pay Plan 20, The State's Alternative Pay Plan, Department of Administration (orig. 06P-06)

ATTACHMENT: Original Performance Audit Summary

INTRODUCTION

In November 2006, we presented our performance audit of Pay Plan 20, the State's Alternative Pay Plan. The audit made five recommendations to the Department of Administration. In November 2007, we began gathering information from the department on progress in implementing the recommendations. This memo summarizes the results of our follow-up work in addition to presenting background information on the program.

Overview

Audit recommendations focused on improving the market analysis process, as well as monitoring achievement of desired outcomes. The Department of Administration commissioned a State Pay Task Force to guide the department's efforts in designing and implementing a valid market analysis process, and to assist the department in reporting on agency recruitment and retention success. The Task Force continues to assist and guide the department's efforts to implement the recommendations resulting from our performance audit. Of the five recommendations in the report, three have been implemented and two are being implemented.

BACKGROUND (from original audit report)

The Montana 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 original pay plan took the form of a matrix containing vertical grades and horizontal steps. In 1979, the legislature authorized the Department of Administration (DOA) 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 pay matrix, replacing steps with an open-range progression to reflect a more market-based pay philosophy. The 1997 Legislature directed DOA to develop an alternative classification and pay system. This alternative system, called Pay Plan 20, is a market-based and competency-based pay plan, referred to as the broadband pay plan. Broadbanding is a method of defining occupations and associated pay ranges to enable more flexibility in pay administration. Broadbanding consolidated the 25-grade pay matrix into nine bands, each band having a broader minimum to maximum pay range. Broadbanding allows agencies to award pay increases according to their own pay policies and within agency approved operating plans. House Bill 13, the state pay plan bill passed by the 2007 Legislature, adopted Pay Plan 20 as the statewide pay plan.

FOLLOW-UP AUDIT FINDINGS

The performance audit report included five recommendations to the department. Four of the five recommendations focused on improving the market analysis process, and the other recommendation addressed establishment of a system for monitoring desired outcomes. The following summarizes information relating to follow-up audit work and the implementation status of recommendations.

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.

Implementation Status – Implemented

As mentioned, the department commissioned a State Pay Task Force to assist in decision-making regarding the market analysis process. Task Force membership included management personnel from various agencies, as well as the Governor's Office, and was staffed by DOA personnel. During the original audit, a discounting procedure was used by DOA as part of the market analysis process to adjust national survey data in order to approximate the relationship of Montana salaries to national salaries. The Task Force discussed discounting at several meetings, along with related discussions about sources of salary data and using a regionalized approach. The Task Force recommended DOA not discount any salary data in order to obtain true market-based occupational pay ranges. DOA followed this advice and has stopped discounting salary data.

In addition, DOA obtained opinions from the Task Force and various state agency human resources personnel regarding a change in salary survey data sources. At the time of the original audit, DOA used three sources of salary data to establish market rates: 1) Central States Compensation Association (CSCA), 2) Occupational Employment Statistics (OES), and 3) Watson Wyatt (WW). The OES national data and WW data were discounted. DOA provided information related to other available sources for salary data. One of these sources was Salary.com, a web based company. Salary.com compiles salary data from numerous sources, including WW data, and provides salary data and services to its customers. Salary.com made a presentation to a group of state human resource personnel and provided the group with free access to their database to test its usefulness. Due to better job matches, more sources of data, and up-to-date data, DOA believes Salary.com is a viable tool and provides more appropriate data for obtaining market rates. The Task Force unanimously recommended use of Salary.com data, and DOA replaced WW with Salary.com data. DOA used CSCA data, OES regional data, and Salary.com data to establish the 2008 market rates.

Discussions among the Task Force identified a need for educating state employees about Pay Plan 20 and the establishment of market rates. During these discussions, the Task Force identified a potential for creating unrealistic expectations with the terms used for occupational pay ranges. In the past, DOA established a market rate for each occupation, and then calculated a pay range based on the market.

The range had a minimum, market, and maximum pay rate. Task Force discussions indicated some state employees believe they have an opportunity to achieve the maximum pay rate for an occupation. While Pay Plan 20 allows this flexibility, most state agencies do not have adequate funding to even pay state employees the market rate. As a result, the Task Force recommended elimination of the maximum pay rate. Further discussions regarding occupational pay ranges, including market pay rates being a guideline for agency managers to use in establishing individual pay, resulted in elimination of the minimum pay rate; thus eliminating the range for market pay rates. DOA now reports only the actual market rate for each occupation. Market rates will be updated every two years and the new rates will be reported whether or not the rates increased or decreased from the previous cycle.

Recommendation #2

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

Implementation Status – Implemented

During its deliberations, the Task Force discussed the relevant labor market for Montana state government. DOA proposed a tiered system for development of market rates. After numerous discussions, the Task Force recommended a two-tiered system. The first tier would be the standard market analysis process and would include salary data from the three sources mentioned previously for the states of Montana, Idaho, North Dakota, South Dakota, and Wyoming. In addition, if any salary data is older than one year, DOA personnel will age the data (i.e., make the data more current) by using the most current employment cost index provided by the U.S. Department of Labor. The second tier will be a customized market analysis, requested by a state agency, used for hard-to-fill positions within Montana state government. The Tier II analysis will be used when the standard market rate for an occupation has historically failed to attract an adequate pool of qualified applicants. DOA used the new two-tiered system to establish the 2008 market rates.

Recommendation #3

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

Implementation Status – Being Implemented

A “desk reference” is being developed to document procedures used for market analysis and other Pay Plan 20 related processes. According to department personnel, a final draft of the desk reference should be available by the end of September 2008.

Recommendation #4

We recommend the department approve market rates for all occupations.

Implementation Status – Implemented

With the passage of House Bill 13 by the 2007 Legislature, all state agencies are now under Pay Plan 20. Section 2-18-301(8), MCA, now requires DOA, based on its biennial salary survey, to identify current market rates for all occupations. To ensure accurate job matches, DOA will solicit input from subject matter experts and agency human resources representatives before setting occupational pay rates. As mentioned previously, a customized market analysis may be used for hard-to-fill positions, but this must be requested by a state agency, and DOA will only complete the Tier II analysis upon receiving consensus from all state agencies employing the specific occupation in question.

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.

Implementation Status – Being Implemented

One of the purposes of the Task Force was to assist DOA in collecting, recording, and reporting state agencies' pay practices and their success addressing recruitment and retention problems. Task Force meetings included discussions about various metrics related to recruitment and retention. Some of the metrics discussed were:

- Retention – includes overall turnover rate, where employees go when they leave (internal, external, out of state government), why they leave (pay, career, workload, etc.), voluntary versus involuntary turnover, and turnover in relation to number of years of service.
- Recruitment – includes number of applicants for each recruiting effort, number of recruiting efforts per position, amount of time needed to hire (with and without advertising time), and where and why applicants are screened out of the process.

The Task Force identified numerous areas where data should be collected, and DOA provided recommendations for establishing systems to collect and analyze information related to recruitment and retention. Suggested systems include SABHRS, a centralized exit interview system (SurveyMonkey), and a centralized Internet-based application system. DOA is currently testing the exit interview survey system, and is in the development stage of the application system. The Task Force recommended all state agencies be required to use the online application system to ensure consistency in data collection.

ADDITIONAL INFORMATION

While DOA has, or is, addressing the recommendations in the audit report, there were also several conclusions reached as a result of the original audit work. Two of these conclusions included:

- Pay plan variations among state agencies have created differences in pay.
- The concept of broadbanding is a major change in the compensation philosophy and organizational culture for the State of Montana.

During the audit, we noted 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. Task Force discussions commonly referred to this phenomenon as pay disparities or inequities. The main reason for differences in pay is availability of funding. For example, if one agency has sufficient funds to pay its employees 100 percent of market, but another agency only has funding to pay 80 percent of market, similar occupations between the two agencies may be paid differently. These situations lead to competition for employees among agencies.

The original audit report also identified some key questions regarding Pay Plan 20 the legislature should consider in order to make an informed decision. Among these were:

- How important is market-based pay?
- Can the state afford to pay market-based salaries?
- Should Montana lead, match, or lag the market?

The 2007 Legislature provided one-time-only funding in House Bill 13 to bring all employees up to a minimum of 80 percent of market. In addition, many agencies implemented agency pay plan rules for paying employees a certain percentage of market. At least one state agency is paying 100 percent of

market, while some other agency pay plan rules use a progression over several years to attain market rates. With the changes in DOA's market analysis process as described above, the overall market rates for 2008 increased on average by about 11 percent. As a result, some agencies may not be able to maintain employee pay at a minimum of 80 percent of market and/or maintain agency pay plan rules related to market percentages. This may cause managers to have to adjust individual agency pay plan policies to address increases in market rates.

During its deliberations, the Task Force discussed whether there should be a minimum pay level for all state employees and what this level should be. Additionally, the Task Force discussed the potential for a long-term goal for the State of Montana to pay all employees at 100 percent of market. Preliminary discussions indicated a need for additional funding in order to obtain a minimum level for all state employees. Due to variations in sources and availability of funding, the Task Force did not identify a single solution for accomplishing this goal.

As stated in the original audit report:

> *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.*

House Bill 13, passed by the 2007 Legislature, included both an across-the-board pay increase, as well as a discretionary component. Specific language in the bill included:

> "Effective October 1, 2007, and October 1, 2008, the appropriation that represents six-tenths of one percent of the salary for each full-time equivalent position must be allocated to each agency to distribute to its employees for reasons including but not limited to market progression, job performance, or employee competencies."

This six-tenths pay component is commonly referred to as the discretionary pay component. Agency managers used numerous methods for distributing discretionary pay including across-the-board, market progression, performance-based, competency-based, differential pay, and various combinations of these methods. According to DOA statistics, approximately 44 percent of state employees received discretionary pay raises in 2007.

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