

State of Arizona

Janet Napolitano

Governor of Arizona

Betsey Bayless

Director, Department of Administration

Arizona Department of Administration HUMAN RESOURCES SYSTEM

2004

ADVISORY RECOMMENDATION



BETSEY BAYLESS
DIRECTOR
ARIZONA DEPARTMENT OF ADMINISTRATION

September, 2004

The Honorable Janet Napolitano
Governor, State of Arizona
The Honorable Ken Bennett
President, Arizona State Senate
The Honorable Franklin "Jake" Flake
Speaker, Arizona House of Representatives
1700 West Washington
Phoenix, Arizona 85007



Dear Governor Napolitano, President Bennett and Speaker Flake:

It is my pleasure to share with you the 2004 Annual Advisory Recommendation on the salaries of our State employees.

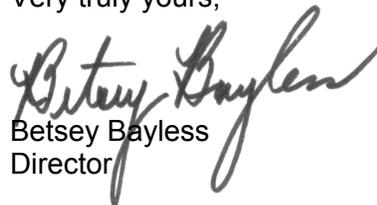
On behalf of all state employees, we recognize and sincerely appreciate the efforts of the Governor and the Legislature to provide funding for salary adjustments during recent years. These increases were desperately needed. The General Salary Adjustment of \$1,000, effective July 1, 2004, helped prevent further deterioration of the state's relative market position.

Our need to attract and retain professional, highly trained employees remains a paramount concern. In spite of recent salary adjustments, state salaries are still considerably behind the market; in this report you'll find our employees are 20% behind the Arizona market and 26% behind the Western States. As a result, many of our best state employees continue to be drawn to other employers.

The State continues to face financial difficulties; however, we must establish State employee pay as a priority. We must begin to close the gap between our salaries and the market to avoid severe negative implications on our ability to deliver even the most basic of State government services.

We hope that the Annual Advisory Recommendation will provide the information you need when making decisions regarding Arizona State government and its employees' compensation.

Very truly yours,


Betsey Bayless
Director

ARIZONA DEPARTMENT OF ADMINISTRATION

2004 ANNUAL ADVISORY RECOMMENDATION

The Arizona Department of Administration (ADOA) Human Resources System has a responsibility to recipients of state government services to delivery high quality, timely services. Lack of adequate pay for ADOA Human Resources System employees leads to high turnover and an inability to attract sufficient qualified candidates and retain talent. The result is that services, quality and timeliness are hampered by staff shortages and the need to continually hire and train new staff.

As the largest employer in the State, and as a public employer, ADOA has an obligation to the taxpayers to recruit and retain an effective, productive, efficient and stable workforce. It is important to pay employees competitively, to respect the talents brought to our organization, and to recognize and reward results and accomplishments.

The salary adjustments appropriated for the ADOA Human Resources System have not allowed the state to reach or to keep pace with compensation paid in the labor market. Regardless of whether ADOA Human Resources System salaries are measured against local, regional, public or private entities, they are not competitive. This report describes the wide and growing gap between the compensation of ADOA Human Resources System employees and that paid by other employers, and the overall impact.

STATUS OF CURRENT COMPENSATION

There are currently **30,831** covered state employees in the ADOA Personnel System. The average salary for covered state employees is **\$32,013**.

To stay abreast of what the competition is paying for similar type jobs/classes, ADOA conducts and participates in a number of salary surveys. The primary sources used for salary comparisons include the **Arizona Compensation Survey (ACS)**, formerly Joint Governmental Salary Survey (JGSS) and the **Western States Salary Survey**.

Arizona Compensation Survey

In March 2004, 172 public and private companies located in the state of Arizona participated in the ACS, covering 127 benchmark jobs representing over 220,000 employees. The survey indicated the following:

- Average salaries of state employees are **20.4%** lower than public and private employers located in the state of Arizona. In 2003, the difference was 19.0%.
- Average salaries of state employees are **24.9%** lower than public employers located in the state of Arizona. Public employers located in the state of Arizona included the cities of Casa Grande, Chandler, Coolidge, Cottonwood, Flagstaff, Fountain Hills, Glendale, Globe, Lake Havasu, Marana, Phoenix, Prescott, Prescott Valley, Scottsdale, Sierra Vista, Surprise, Tucson, Wickenburg, Winslow and Yuma. Counties included are Cochise, Coconino, Maricopa, Mohave, Pima, Pinal and Yuma.

- Average salaries of state employees are **35%** lower than the public employers located in Maricopa County. Public employers located in Maricopa County included Scottsdale, Glendale, Fountain Hills, Chandler, Surprise and Phoenix.

Western States Survey

In March 2004, 26 public employers participated in the Western States Salary Survey, covering 139 benchmark jobs representing over 80,000 employees in cities, counties and state governments located in the 12 western states. The survey indicated the following:

- Average salaries of state employees are **25.9%** lower than public employers located in the 12 western states. In 2003, the difference was 21.3%.

Other Sources

Other sources used in the review of the market position of state employee salaries include Central States Compensation Association survey, Eller College of Business and Bureau of Labor Statistics.

According to the 2003 Central States Compensation Association survey (which includes all Western states except California), Arizona's total compensation average is **\$44,301**. Total compensation is defined as the total value of an employee's direct and indirect compensation provided by the employer. The following chart, Figure 1, shows the specific comparisons from the survey:

Figure 1 Total Compensation Comparison

State	Average Salary	Benefits Cost	% of Salary	Total Compensation
WISCONSIN	\$49,782	\$18,103	36%	\$67,885
ILLINOIS	\$46,276	\$19,821	43%	\$66,097
COLORADO	\$49,038	\$13,723	28%	\$62,761
IOWA	\$44,504	\$17,978	40%	\$62,482
MICHIGAN	\$43,994	\$18,116	41%	\$62,110
NEVADA	\$44,427	\$17,286	39%	\$61,713
MINNESOTA	\$45,372	\$15,658	35%	\$61,030
OREGON	\$40,692	\$15,135	37%	\$55,827
LOUISIANA	\$36,409	\$18,165	50%	\$54,574
IDAHO	\$38,728	\$15,717	41%	\$54,445
WYOMING	\$35,844	\$15,430	43%	\$51,274
UTAH	\$36,164	\$13,195	36%	\$49,359
NEW MEXICO	\$34,362	\$14,488	42%	\$48,850
TEXAS	\$34,173	\$12,320	46%	\$46,493
SOUTH DAKOTA	\$32,427	\$13,898	43%	\$46,325
NORTH DAKOTA	\$34,353	\$11,348	33%	\$45,701
MONTANA	\$32,167	\$12,936	40%	\$45,103
OKLAHOMA	\$32,695	\$14,094	46%	\$45,065
KANSAS	\$33,996	\$10,328	30%	\$44,324
NEBRASKA	\$32,384	\$11,939	37%	\$44,323
ARIZONA	\$31,859	\$12,442	39%	\$44,301
ARKANSAS	\$31,064	\$12,610	41%	\$43,674
MISSOURI	\$28,950	\$13,639	47%	\$42,589
INDIANA	\$28,553	\$12,328	43%	\$40,881
Average	\$37,426	\$14,612	40%	\$51,966

Source: 2003 Central States Compensation Association Survey

As can be seen in this table, Arizona ranks 21st out of the 24 states responding.

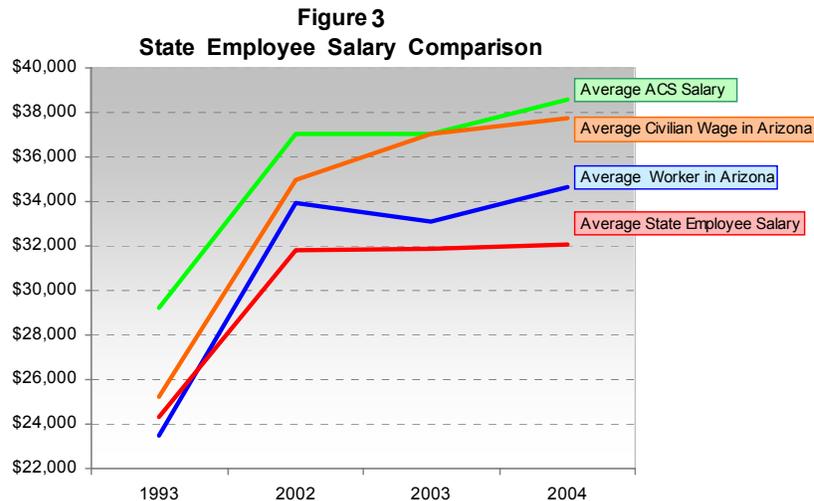
Further evidence of the low salaries that Arizona pays is shown in Figure 2 below. Arizona ranks 49th in the nation in the ratio of total state payroll as compared to overall population of the state.

Figure 2 Ratio of Total State Payroll to State Population

1.....	Alaska	26.....	Maine
2.....	Hawaii	27.....	Virginia
3.....	Delaware	28.....	West Virginia
4.....	Connecticut	29.....	Mississippi
5.....	Vermont	30.....	Michigan
6.....	New Jersey	31.....	Nebraska
7.....	North Dakota	32.....	Kansas
8.....	Rhode Island	33.....	Idaho
9.....	New Mexico	34.....	Oregon
10.....	Washington	35.....	North Carolina
11.....	Utah		United States Average
12.....	Wyoming	36.....	New Hampshire
13.....	Iowa	37.....	South Dakota
14.....	Maryland	38.....	California
15.....	Montana	39.....	Wisconsin
16.....	Alabama	40.....	Pennsylvania
17.....	Louisiana	41.....	Missouri
18.....	Minnesota	42.....	Indiana
19.....	Kentucky	43.....	Georgia
20.....	Massachusetts	44.....	Illinois
21.....	Oklahoma	45.....	Tennessee
22.....	Colorado	46.....	Ohio
23.....	Arkansas	47.....	Texas
24.....	New York	48.....	Nevada
25.....	South Carolina	49.....	Arizona
		50.....	Florida

Source: State Payroll data from U.S. Census Bureau, Governments Division. March 2002. Population data from U.S. Census Bureau, Population Division, estimates for July 1, 2002.

As shown in Figure 3, *State Employee Salary Comparison*, the Average State Employee Salary trend line continues to fall below all other Arizona market wage indicators.



Source: Average Civilian Wage in Arizona, Eller College of Business, March 2004.¹
 Average Worker in Arizona, BLS, December 2003, aged 1%
 Average State Employee, HRIS, State of Arizona, June 2004
 Average ACS Salary, Arizona Compensation Survey, March 2004

Eller College of Business figures include total Arizona non-agricultural workers. **BLS** figures include all types of employment for full- and part-time workers, including seasonal and temporary, in construction, manufacturing, retail, finance, transportation, government, and services in large Arizona cities. **HRIS** figures include covered, permanent full-time employees, **ACS** figures include selected benchmark positions.

OUTLOOK OF THE MARKET

The ability of an organization to attract and retain key personnel has never been more challenging. Research suggests the available labor pool will become sought after, and competition for the knowledge workers of the future will increase. It is critical to recognize that the labor market is not static, and efforts on the part of the State to become more competitive are counterbalanced by other employers' efforts to do the same. Some key facts in this regard are listed below.

- A projected shortage of 8 million workers by 2010. (Bureau of Labor Statistics)
- The labor force will continue to age, with the number of workers in the 55-and-older group projected to grow by 49.3 percent, 4 times the 12-percent growth projected for the overall labor force. In 2012, youths, those between the ages of 16 and 24, will constitute 15 percent of the labor force, and prime-age workers, those between the ages of 25 and 54, will make up 66 percent of the labor force. The share of the 55-and-older age group will increase from 14.3 percent to 19.1 percent of the labor force. (Bureau of Labor Statistics)
- With the improving economy, fewer companies at the national level (5 percent, down from 12 percent in 2003) report salary freezes this year. Similarly in Arizona fewer participants (5 compared with 14 in 2003) reported salary freezes. Projected salary increases are shown in Figure 4 below.

Figure 4 Actual/Projected Salary Increases

	2004 Actual/Projected % Increase	2005 Projected % Increase
National – Mercer	3.3	3.5
National – Conference Board	3.5	3.5
National – WorldatWork	3.5	3.7
Arizona – Public	2.9	4.1
Arizona – Private	4.0	4.2
State of Arizona	3.1	??

Source: National Data from Mercer, WorldatWork, and Conference Board²
Arizona Data from Arizona Compensation Survey

- The state implemented a \$1,000 General Salary Adjustment (GSA) effective July 1, 2004. The GSA should keep the state from falling even further behind other market indicators, although as can be seen by the advances made in other organizations, the State's market position will not improve. The GSA represents an average of 3.1%, which is less than the predicted 3.4% overall increase in 2004 for Arizona.

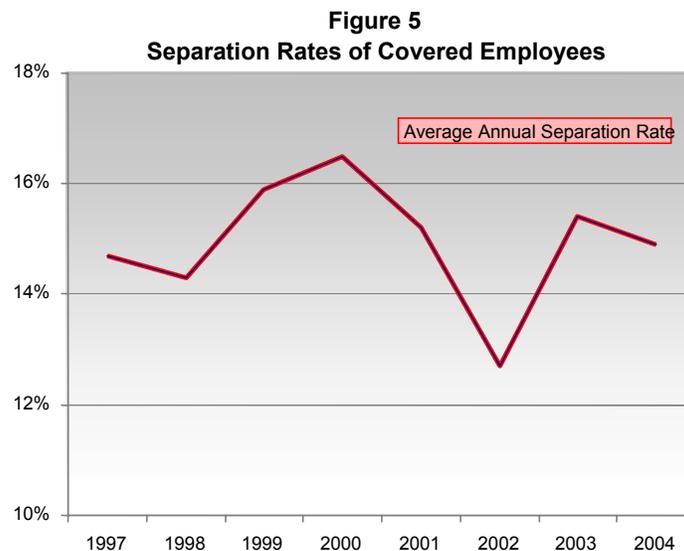
² **Mercer Human Resources Consulting, Inc.** - international human resources consulting firm in compensation and benefits; provider of salary surveys, studies, and trend analysis for the private and public sectors. **WorldatWork** - world wide nonprofit association dedicated to compensation, benefits, total rewards, and HR professionals. **Conference Board** - nonprofit organization that creates and disseminates information about management and the marketplace to help businesses assess the current economic picture and intelligently forecast trends.

IMPACT

The lack of consistent, substantive funding for employee pay increases has had a significant impact on retention and the State's classification/compensation system. Retention is the most immediate and direct consequence of inadequate funding of a compensation system. Less immediate, though no less significant is the gradual erosion of the systematic and comprehensive classification and compensation system.

Retention

The current separation rate for covered (merit system) employees is **14.9%**. Of the 4,586 covered employees leaving state service, 3,726 left voluntarily (81%). Figure 5 illustrates the seven year turnover trend.



Source: 2004 Arizona Department of Administration Human Resources System Annual Report

With the exception of 2002, the state's turnover rate has held fairly steady around 15%. As can be seen from Figure 6 below, this rate of separation is higher than 80% of the other central states.

Figure 6 Separation Rate Comparison

State	Statewide Total %	Voluntary Resignations	Involuntary Terminations	Retirements
MINNESOTA	4.74%	2.80%	not reported	not reported
IOWA	6.34%	2.80%	1.67%	1.87%
UTAH	9.26%	6.14%	1.06%	2.06%
NEVADA	10.0%	8.5%	1.4%	2.5%
MICHIGAN	10.30%	not reported	not reported	not reported
COLORADO	11.02%	6.15%	1.84%	3.03%
MONTANA	11.37%	9.40%	31.00%	1.65%
OKLAHOMA	12.0%	8.0%	2.0%	2.0%
SOUTH DAKOTA	12.40%	8.50%	2.10%	1.40%
WYOMING	12.40%	not reported	not reported	not reported
KANSAS	12.68%	8.57%	1.83%	2.00%
IDAHO	13.00%	not reported	not reported	2.00%
NEBRASKA	13.30%	8.90%	3.20%	1.20%
OREGON	14.30%	4.70%	4.40%	5.20%
NEW MEXICO	14.68%	6.98%	1.50%	1.85%
TEXAS	14.80%	8.90%	3.45%	2.45%
ARIZONA	14.90%	13.10%	2.10%	1.4%
MISSOURI	16.00%	10.1%	14.8%	14.70%
ARKANSAS	17.95%	not reported	not reported	not reported
ILLINOIS	28.40%	3.50%	7.30%	17.60%
Average	12.99%	7.32%	5.31%	3.93%

Source: 2003 Central States Compensation Association Survey

Turnover rates from local municipalities also illustrate that Arizona has a significantly higher rate of separation than some of our neighboring public sector entities.

Figure 7 Separation Rates of Nearby Municipalities
Annual Separation Rates

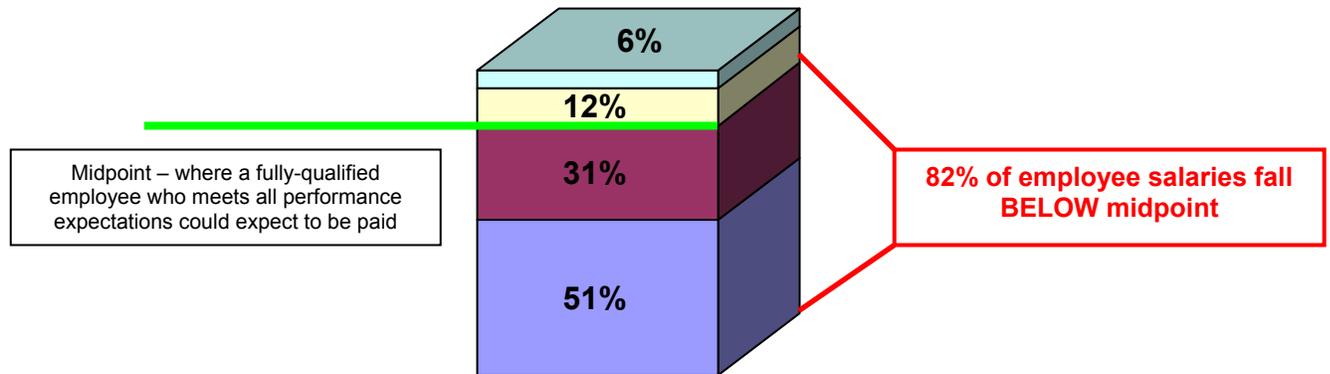
Tempe	4.8%
Glendale	6.7%
Scottsdale	7.3%
Tucson	8.9%
State of Arizona	14.9%

Source: Personal contacts

Over 43% of the state's workforce has less than 4 years of experience working for the State; 4 years is the point at which an employee could be considered to have reached "journey" level and is considered competent in the job. For those employees that do remain in state service, it currently takes an average of 10 years for an employee to reach the midpoint of their pay range. Other organizations typically move their employees up to the midpoint in 4 to 5 years.

Currently over 50% of state employees are in the lowest quartile of their salary range and over 80% are below the midpoint as illustrated below in Figure 8.

Figure 8 Distribution of Covered Salaries within Their Range



Source: The State's Human Resources Information Solution (HRIS)

These factors contribute to the agencies' difficulties in retaining qualified employees. Below are actual examples of employees leaving State service and receiving higher salaries for similar type jobs/ classifications.

- A Senior Resident Engineer was offered \$12,000 more per year, \$7,000 signing bonus and a vehicle. ADOT counter offered but could not match his external offer without exceeding the salaries of other more senior engineers.
- A Resident Engineer left in May 2004 for a position with Federal Aviation Administration for \$85,000 (a \$25,000 increase).
- A construction company hired a Highway Maintenance Tech I in Kingman in January 2004 at a 79% increase (went from \$23,192 to \$41,600).
- Highway Maintenance Tech III, hired by a utility company in October 2003, went from \$28,765 to \$37,500.
- Human Resources Analyst offered position with City of Phoenix in June 2004, with an increase of more than 10% and an additional increase at 6 months.
- Water Resource Engineer recruited by the City of Phoenix with a \$4500 salary increase, and placed into a position with fewer responsibilities.
- A former Correctional Registered Nurse wished to return to work with ADC but declined the offer because of a private sector offer of \$80,000.

Research suggests that employee turnover rates will increase as the economy recovers. The impact of turnover is significant, both directly and indirectly. Direct costs include what we spend on recruiting and training replacement workers. Indirect costs include lost productivity, lower morale among remaining employees who must absorb the workload of the employees who left state service, and customer dissatisfaction from dealing with new and inexperienced employees.

Estimates of the total cost of losing a single person to turnover range from 30% of their yearly salary (Cornell University) to 150% as estimated by the Saratoga Institute, and independently by Hewitt Associates. Using the most conservative estimate of 30%, the financial impacts to the state are very significant. For example, the number of active, covered employees in FY04 was 30,831, making an average salary of \$32,000. Our current turnover rate of 14.9%, yielded 4,586 separations for a total cost over \$44 million. A reduction in the turnover rate of merely 1% would result in savings (cost avoidance) of \$2.9 million.

Erosion of the State's Classification/Compensation System

State agencies are constantly looking for ways to attract qualified candidates and retain experienced, knowledgeable employees. Consequently, we have turned to interim fixes that result in erosion of the State's Classification/Compensation System. One of the results of these stop-gap measures is that only 30%, or less than 11,000 employees, are now paid under the original "regular salary schedule" (grades 1-30). The types of approaches the State has used over the years to assist in addressing the growing gap between compensation of employees in the ADOA Personnel System and that of other employers are illustrated below.

- Positions have been uncovered. Over the past 7 years we have seen an increase of 12% in the ratio of uncovered positions compared to covered positions.
- Special Recruitment Rates are established higher than the grade minimums, and apply to all those hired into a class. Currently, there are 373 covered job codes (classifications) utilizing Special Recruitment Rates; this represents over 1/3 of the covered job codes.
- Special Rates are established for classes when their ranges do not fit the regular salary grades 1-30, or for classes paid on an hourly, daily or per performance basis. There are 61 Special Rates for covered classifications and 108 for uncovered.
- Alternative Salary Plans are established based upon the prevailing practice in the marketplace, e.g., years of experience, examinations completed and passed. There are currently 30 covered job codes (classifications) in Alternative Salary Plans.
- A Step and Grade Plan was established for the Correctional Officer II job code.
- Youth Correctional Officers I receive a salary increase after 12 months of employment.
- Youth Correctional Officers II receive increases at 12 and 24 months of service.
- Teachers are placed in a matrix similar to those utilized by school districts, recognizing continuing educational achievements and service.
- IT positions are paid under a broadband plan.
- Engineers (registered) have a special pay schedule and may move through the schedule.
- Non-registered technical engineering specialists have a special pay schedule and may move through the schedule.

While these approaches have assisted in some areas and in some cases, it still remains a fact that the average salaries of state employees are significantly lower than other employers.

RECOMMENDATIONS

It is essential that State funding for employee salaries has the highest priority, particularly as the economy improves and job opportunities outside the State become more attractive. In past years, there has not been a sufficient investment in our employees; the most vital component that allows State programs to serve their intended purpose. In order to continue to provide quality service and programs that meet the needs of our constituents, adequate funding for the employees must be a priority.

Improve the State's Market Position

Effective July 1, 2004, a \$1,000 General Salary Adjustment (GSA) was implemented. The GSA represents an average 3.1% increase in state employee salaries. Assuming the other employers provided increases at the same rate (as shown on Page 4), it is anticipated that state employee salaries will remain 20% behind the market in FY2005. In order to effect significant change in the salary deficit between state employee salaries and the market, it will be necessary to provide increases greater than that which other employers are providing. There are many strategies that could be implemented; below is one of the models presented in last year's Recommendation that would allow us to significantly close the gap. Assuming employers continue to provide 3% increases each year, a 4.5% increase to state employee salaries would bring our salaries to within 14% of market by FY09.

	<u>Increase</u>	<u>% Increase</u>
FY 06	\$ 59,853,366	4.5%
FY 07	\$ 62,546,767	4.5%
FY 08	\$ 65,361,372	4.5%
FY 09	\$ 68,302,633	4.5%
	<u>\$256,064,138</u>	<u>Total Projected Cost</u>

Move Employees Through the Salary Ranges

Over 50% of state employees are in the lowest quartile of their salary range and over 80% are below the midpoint. There currently is no mechanism to provide increases in salary for individuals that would allow them to advance through their salary range. It is imperative that the State implement an approach to ensure employees progress through the salary ranges. A common strategy employed by many public sector organizations to address this issue is to design some form of steps or automatic progression plan.

Examples of step plans currently utilized by other public organizations are summarized below:

City of Tucson

- 79% of their employees' salaries are administered according to step plans.
- Only non-exempt employees are in the step plan.
- There are 11 grades, each having 14 steps.
- Through step 6, each step represents a 2.5% increase; for step 7 and above the increase is 5.0%.

Pinal County

- Each non-exempt grade has 14 steps and there are 11 grades.
- Salaries move one step at the employee's anniversary date (assuming satisfactory performance) up to step 7, which is midpoint.
- After step 7, movement is every 2 years.
- Each step represents a 2.5% increase.

State of Washington

- Pay plan has 86 grades.
- Each grade has 11 steps
- One step averages a 2.3% increase in salary.
- All "General Government" positions are administered by this plan.

The combination of providing regular GSA's and moving employees through the salary ranges would help address the gap even further than implementing salary increases alone. Many employees have an intangible need to know that there are opportunities for salary increases for remaining with the state and advancing their career.

CONCLUSION

The information that we have illustrated in this report is not new, nor is it information that has not been previously reported. Year after year, similar information is packaged and presented in our annual recommendation. Last year a 3% increase was provided for state employees which helped ensure that state employee salaries did not slip further behind the market. It is critical that we build upon this investment and begin to close the gap between our employees' salaries and those offered by the market. It has never been more important for state government to provide quality service and programs that meet the needs of our constituents – and inspire their trust and confidence. Adequate funding for employees must be a priority in order to achieve that reality.

Resources

The Conference Board
www.conference-board.org

U.S. Department of Labor, Bureau of Labor Statistics
www.bls.gov

Mercer Human Resources Consulting, Inc
www.mercer.com

University of Arizona, Eller College of Business
www.bpa.arizona.edu

WorldatWork
www.worldatwork.org

OTHER ARIZONA DEPARTMENT OF ADMINISTRATION RESOURCES

Human Resources System Annual Report, 2004
www.hr.state.az.us

Salary Schedules for State Employees
www.hr.state.az.us/Classcomp/index.htm

Uncovered Positions and Salary Schedules
www.hr.state.az.us/Classcomp/index.htm