Arizona
HUMAN RESOURCES

State of Arizona
Advisory Recommendation

2007

Janet Napolitano
Governor

William Bell
Director, Department of Administration

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ARIZONA DEPARTMENT OF ADMINISTRATION

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The Honorable Janet Napolitano
Governor, State of Arizona
The Honorable Tim Bee
President, Arizona State Senate
The Honorable James Weiers
Speaker, Arizona House of Representatives
1700 West Washington
Phoenix, Arizona 85007

Dear Governor Napolitano, President Bee and Speaker Weiers:

On behalf of all state employees, we recognize and appreciate the efforts of the Governor and the Legislature to provide funding for salary adjustments during recent years. The salary increase that went into effect on March 11, 2006, and the most recent increase authorized in HB 2781 have begun to close the significant gap between our state employee salaries and the market.

Although we have made great strides in closing the gap between state employee salaries and the market, our need to attract and retain professional, highly trained employees may never be more critical. The competition for talent is increasing, more and more state employees are becoming eligible for retirement, and the market continues to move forward. As a result, many of our best state employees continue to be drawn to other employers.

The following recommendation provides an objective assessment of the job market and the average salaries paid to Arizona state workers. However, the Department of Administration understands and appreciates the realities of the current economic situation of the State's budget. Therefore, a specific salary increase is not included in this year's recommendation. We are committed; however, to partner with the budget offices to investigate strategies and specific options as more information about the State's fiscal status becomes available.

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

Sincerely,

William Bell
Director

2007 Advisory Recommendation on State Employee Salaries

Every September, the Arizona Department of Administration (ADOA) provides an Annual Advisory Recommendation to the Governor and the Legislature pursuant to A.R.S. §41-763.01. This document provides an analysis of the state's current compensation levels compared to other public and private sector employers, and a review of the critical factors that must be considered when reviewing compensation strategies. These factors include turnover rates, retirement projections, impacts to the labor market, and projected market movement. The report concludes with a recommendation that sets a strategic direction to ensure the state remains competitive with other employers and attracts and retains a competent, productive, and satisfied work force.

This report reflects the current status of Arizona State employee compensation as it relates to market conditions at the end of Fiscal Year 2007. The guidelines contained herein are provided as a resource to guide statewide budget considerations during the preparation of the Fiscal Year 2009 budget.

METHODOLOGY

This year ADOA made changes to the methodology used to analyze the State's current compensation levels compared to other public and private sector employers. First, ADOA expanded the number of salary surveys used to compare salaries to the market. This provided the opportunity to not only include more employers in the comparison, but also increased the number of benchmark jobs (and the number of employees in those jobs) that were used in the market comparisons. Second, ADOA used state employees' base salary and performance pay to compare state employees' salaries to market. In the past, only base salaries were used.

HISTORY OF COMPENSATION

Over the past several years, the state has implemented a number of different strategies to adjust employee salaries. These strategies included general salary adjustments, merit adjustments, special market adjustments, and other miscellaneous adjustments specifically addressed by the legislature. However, there have also been years where no salary adjustments were funded.

In 2005, the Department of Administration recommended a 5-year plan to bring employee salaries to within 5% of the prevailing job market. The plan developed in 2005 was used to guide the development of the FY 2007 budget, a budget that included an appropriation of a flat dollar amount ($1,650) to increase employee's base salary, and the introduction of a pay practice for Arizona state government employees called "performance pay". Performance pay is available to state employees if the governmental unit meets or exceeds prescribed performance measures. If the measures were not met, the employees in that unit are not entitled to receive performance pay.

In 2006 the Department of Administration recommended continuation of the original 5-year plan. The FY 2008 budget included an appropriation that provided for a 3.0% increase to base salaries, and an increase in the funding authorized for performance pay, bringing the total amount of performance pay available up to 2.75%.

Figure 1
History of the State's Compensation Adjustments

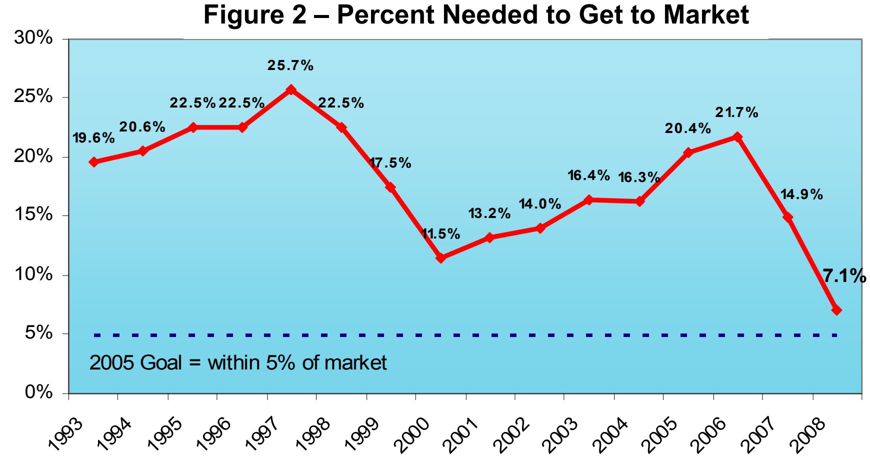
Recommendation Year (Calendar Year)	Budget Year (Fiscal Year)	Average Covered Salary	General Salary Adjustments	Merit or Performance	Allocations for Selected Classes
1996	1998	$26,874	2.5%	2.5% Merit	Yes
1997	1999	$28,249	-0-	2.5% Merit	Yes
1998	2000	$29,208	-0-	2% Merit	Yes
1999	2001	$29,725	-0-	2% Merit	Yes
2000	2002	$30,331	$1,450		
2001	2003	$31,824	-0-		
2002	2004	$31,859	-0-		
2003	2005	$32,059	$1,000		Yes
2004	2006	$32,897	1.7%		Yes
2005	2007	$36,195	$1,650	2.5% Perf Pay	Yes
2006	2008	$38,023	3.0%	0.25% Perf Pay	Yes

Source: Joint Legislative Budget Committee FY2008 Appropriations Report. Merit Adjustment figures represent the percentage allocated to an agency's personnel services base. Allocations for Selected Classes are provided to address specific job classes or specific agency needs addressed by legislation. Average Covered Salary data are based on regular covered employees in agencies within the ADOA Personnel System calculated as of the end of July; figures for FY 2007 and FY 2008 have been adjusted to account for performance pay.

CURRENT STATE OF COMPENSATION

The job market is a constantly moving target, and state salaries must continually be analyzed to assess the competitive position of the state with respect to the market. The most recent analysis of market competitiveness suggests the market exceeds state salaries by an estimated 7.1%. Figure 2 below illustrates the relative difference between state salaries and the market.

Figure 2 – Percent Needed to Get to Market



Source: Percent Needed to Get to Market is based on a suite of compensation surveys, including the Arizona Compensation Survey (previously refered to as the Joint Governmental Salary Survey). Average State Employee Salaries are based on covered employees in the ADOA Personnel System calculated as of the beginning of the fiscal year (July 1). Estimates for FY 2008 have been adjusted to account for performance pay.

FUTURE CONSIDERATIONS

There are a number of factors that must be considered in developing a strategy to ensure state salaries become competitive.

Market Movement

When reviewing information from compensation consulting firms, employers are asked to predict or project the increases that will occur in the future. Several surveys were analyzed to identify an overall projection (Figure 3). It is estimated that the job market is likely to increase by 3.8% during FY 2008.

Figure 3 – Actual and Projected Salary Increases

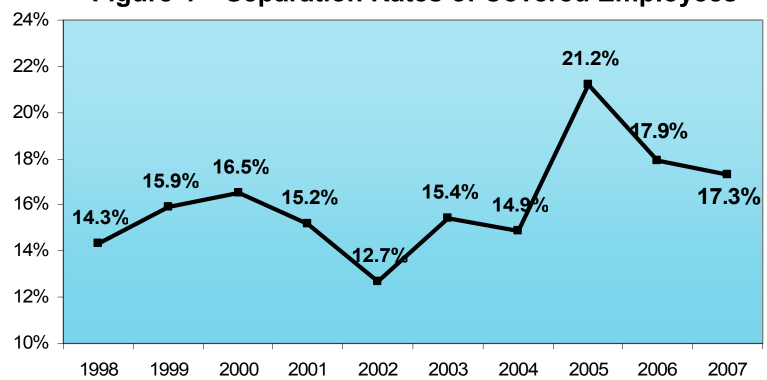
Reference	2007 Actual Increase	2008 Projected Increase
National – Mercer	3.9%	3.8%
National – WorldatWork	3.9%	3.9%
National – Hewitt	3.9%	3.8%
Arizona – ACS	3.9%	3.8%
State of Arizona	**3.0% +0.25%**	**TBD**

Source: National data from Mercer, WorldatWork, and Hewitt websites; Arizona data from 2007 Arizona Compensation Survey

Turnover

The separation rate of covered employees decreased in 2007 from near historic highs of over 21% (Figure 3). This rate represents the second consecutive year of decreasing turnover rates and suggests a return to what had been a reasonably steady average of 15%-16%. This figure makes an interesting supplement to Figure 2 on page 3, which shows the trend of state salaries compared to the market. When state salaries were closest to the market (2000 and 2001), the turnover rates dropped sharply in the following years. After that time, as state employee salaries began to fall significantly behind the market, the state experienced ever increasing turnover rates. As the state's market competitiveness has returned, it is hoped that turnover rates will continue to decline.

Figure 4 – Separation Rates of Covered Employees



Source: 2007 State of Arizona Workforce Report. Separations are defined as covered employees leaving state service during the fiscal year (July 1 to June 30).

Although turnover rates are decreasing, it is important to note that the state is experiencing higher turnover than other states, and higher turnover than other local public sector employers (Figures 5 and 6)

Figure 5 – Separation Rates of Local Public Employers

Employer	Annual Separation Rate
Pima County	4.9%
Phoenix	6.6%
Gilbert	7.0%
Scottsdale	9.0%
Glendale	9.4%
Tempe	9.8%
Average	**10.9%**
Maricopa County	11.6%
Peoria	12.8%
Flagstaff	16.5%
State of Arizona	**17.3%**
Wickenburg	21.0%

Source: Individual Contacts, Information presented is the most current available. Average illustrates simple average of local employers excluding the State of Arizona.

Figure 6 – Separation Rates of State Governments

State	Annual Separation Rate
Minnesota	4.3%
Michigan	5.0%
New Mexico	10.7%
Washington	11.1%
Wyoming	11.5%
Utah	11.9%
Colorado	12.3%
Montana	12.6%
Nebraska	13.6%
Idaho	14.0%
National Average	**15.2%**
Texas	16.6%
State of Arizona	**17.3%**

Source: Individual Contacts and web pages; information presented is the most current available. National average from U.S. Dept of Labor, Bureau of Labor Statistics; values represent separations from State and Local governments during FY 2007.

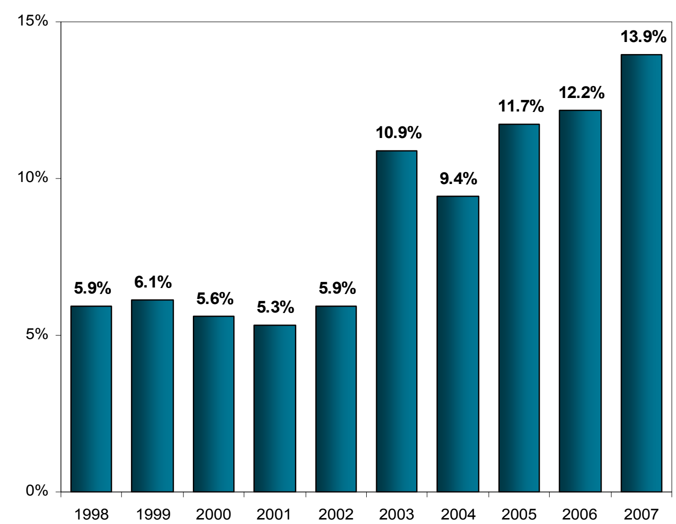
When an employee leaves an organization, the organization usually experiences substantial costs. Costs to the employer may include decreased productivity, costs of hiring a new employee, increased training time, and other indirect costs. The estimated total cost of losing a single person to turnover range from 30% of their yearly salary to 150%. The current turnover rate of 17.3% results in an estimated total cost of over $57.7 million (2007 State of Arizona Workforce Report). If the State were to reduce turnover to the national average for state and local governments (15.2%), the cost avoidance generated would be nearly $7 million.

Increasing Retirement

One of the most critical issues facing the state is the ability to retain a skilled and effective workforce. This may be especially poignant with the well-documented trend of increasing retirements and the loss of institutional knowledge. Figure 7 shows that the percentage of separations as a result of retirement has significantly increased over the last five years and is currently at the highest level in recent history. The average rate from 1998 through 2002 was 5.8%; the rate in 2007 was over 2.4 times greater.

The projections for the future suggest this pattern is not likely to change. Half of the larger state agencies are expected to have over 25% of their active workforce eligible to retire in the next five years (2007 ADOA Human Resources System Annual Report).

Figure 7 – Percent of Separations Due to Retirement



Source: 2007 State of Arizona Workforce Report.

Tightening Labor Market

Another factor that must be considered when developing a strategy to address employee salaries is the state of the economy. As the population ages, employees are particularly in need in the area of health care. And as more products and services go digital, the competition for information technology workers continues to intensify. There is also a high demand for workers in sales, clerical, education, financial services, accounting, and customer service categories. “Unemployment is at a historically low level” said the chief operating officer at CareerBuilder.com. “I think in 2007 we’ll see steady growth, much more of an employee market.” With baby boomers starting to retire and shortages of skilled workers in many key areas, demand is expected to result in not only higher salaries, but also in more career advancement and opportunities for flexible work environments.

Even as the competition for talent intensifies at the national level, Arizona’s unemployment rate in July 2007 was 3.7 percent. This is significantly lower than the unemployment rate at the national level (4.6%), suggesting that the competition for skilled employees will be even more intense in Arizona. In order to attract and retain the talent needed by the state, salaries must remain competitive with the market.

CONCLUSION

The state made significant progress towards improving the position of state employee salaries to the market during FY 2007, and reaffirmed commitment to address salary issues with the increases budgeted for FY 2008. Although the state has made significant progress toward closing the gap, the market still exceeds the state by 7.1%. Furthermore, turnover rates are much higher than comparable employers, and the market is projected to move by 3.8% in the coming year. In order for the state to effectively recruit and retain the key talent that is necessary in what is expected to be an ever increasingly competitive job market, the state must continue making progress at bringing salaries closer to market levels.

RECOMMENDATION

The Advisory Recommendation on State Employee Salaries, published in September 2005, outlined a multi-year strategy with a goal to bring employee salaries within 95% of market in five years. The past two years, the Executive and Legislative branches sent a clear message to state employees that salary issues were important. During the development of the FY 2007 budget, state employee salaries were addressed early in the budgeting process and employees were provided an increase of $1,650, and a new program for performance pay was introduced which afforded eligible employees an additional 2.5%. The development of the FY 2008 budget also demonstrated a significant commitment to address salary issues with an appropriation of 3.0% and an increase of 0.25% to the performance pay program, raising the total available through performance pay to 2.75%.

This year's recommendation includes the following components:

- Continuation of the multi-year strategy and the goal to be within 95% of market by FY 2011
  - The first two years of the plan (Fiscal Years 2007 and 2008) resulted in bringing salaries closer to market. By remaining committed to this plan, it is expected that the state will achieve the goal of being within 5% of the market.
- In order to continue the State's progress toward the goal of being within 95% of the market, salary increases should be implemented.
  - The gap between state employee salaries and the market is too large to address in one year. The Department of Administration is not recommending a specific amount of increase at this time, but will partner with the budget offices as more information about the State's fiscal situation becomes available.
- Continuation of Performance Pay