



Douglas A. Ducey
Governor

Craig C. Brown
Director

ARIZONA DEPARTMENT OF ADMINISTRATION

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The Honorable Douglas A. Ducey
Governor, State of Arizona

The Honorable Steve Yarbrough
President, Arizona State Senate

The Honorable J.D. Mesnard
Speaker, Arizona House of Representatives
1700 West Washington
Phoenix, AZ 85007

Dear Governor Ducey, President Yarbrough, and Speaker Mesnard:

Pursuant to Arizona Revised Statutes § 41-751, the 2017 Advisory Recommendation provides information concerning the compensation of State employees and an objective assessment of the job market.

If you have any questions on the attached, please let me or my team know.

Sincerely,

A handwritten signature in cursive script that reads "Craig C. Brown".

Craig C. Brown
Director

2017 Advisory Recommendation on State Employees' Salaries

Introduction

Every year, the Arizona Department of Administration (ADOA) provides an Advisory Recommendation to the Governor and the Legislature pursuant to A.R.S. § 41-751. This document provides an analysis of the State's current compensation levels compared to other public and private sector employers, and a review of turnover rates, retirement projections, and projected market movement. The report concludes with a recommendation to defer any legislative salary increases at the present time.

This report reflects the current status of Arizona State employee compensation as it relates to market conditions at the end of Fiscal Year 2017. The report is provided as a resource to guide statewide budget considerations during the preparation of the Fiscal Year 2019 budget.

Current Environment – State Government

History of Salary Adjustments

Figure 1

History of the State's Compensation Adjustments¹

Budget Year (Fiscal Year)	Average Salary ²	General Salary Adjustments	Merit, Performance, or Retention	Allocations for Selected Classes
1998	N/A	2.5% ³	2.5% Merit	Yes
1999	N/A	-0-	2.5% Merit	Yes
2000	N/A	-0-	2% Merit	Yes
2001	N/A	-0-	2% Merit	Yes
2002	N/A	\$1,450	-0-	No
2003	N/A	-0-	-0-	No
2004	N/A	-0-	-0-	No
2005	N/A	\$1,000	-0-	Yes ⁴
2006	N/A	1.7%	-0-	Yes ⁵
2007	N/A	\$1,650	2.5% Perf Pay	Yes ⁶
2008	N/A	3.0%	Additional 0.25% Perf Pay	Yes ⁷
2009	\$42,251	-0-	-0-	No
2010	\$42,304	-0-	-0-	No
2011	\$42,235	-1.92% ⁸	-2.75% ⁹	No
2012	\$42,322	-0-	-0-	No
2013	\$42,447	-0-	One-Time, 5% Uncovered Retention Pay ¹⁰	No
2014	\$43,832	-0-	2013 One-Time Retention Pay Added to Base Salary ¹¹	No
2015	\$44,116	-0-	-0-	No
2016	\$45,062	-0-	-0-	No
2017	\$45,981	-0-	-0-	No
2018	N/A	TBD	TBD	TBD

¹ Source: Joint Legislative Budget Committee Appropriations Reports. 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.

² Previous reports included average salary of "covered" employees. As a result of Personnel Reform, implemented September 29, 2012, the majority of the State's workforce became uncovered. As a result, the column for average salary has been recalculated to reflect salaries of all employees, both covered and uncovered. Data for years prior to 2008 are not available.

³ Up to maximum of \$1,000 per employee.

⁴ Includes adjustments above \$1,000 for State-employed nurses and for sworn officers in the Department of Public Safety.

⁵ Includes adjustments above 1.7% for sworn officers in the Department of Public Safety and Assistant Attorneys General. In lieu of the 1.7% general salary adjustment, correctional officers in the Department of Corrections and the Department of Juvenile Corrections received \$1,410.

⁶ Includes adjustments above the \$1,650 per FTE and 2.5% performance adjustment for the Auditor General's Office, State-employed nurses and corrections officers in the Department of Corrections and the Department of Juvenile Corrections.

⁷ Includes adjustments above the 3.0% pay adjustments and 0.25% performance adjustment for the General Accounting Office, Assistant Attorney Generals, supervisor correctional officers at the Department of Corrections, security officers at the Arizona State Hospital, officers at the Department of Juvenile Corrections, and sworn officers at the Department of Public Safety.

⁸ Represents 5 furlough days (1.92%) except for certain exempted positions.

⁹ Represents a (2.75%) performance pay reduction intended to eliminate the FY 2007 and FY 2008 Performance Adjustments.

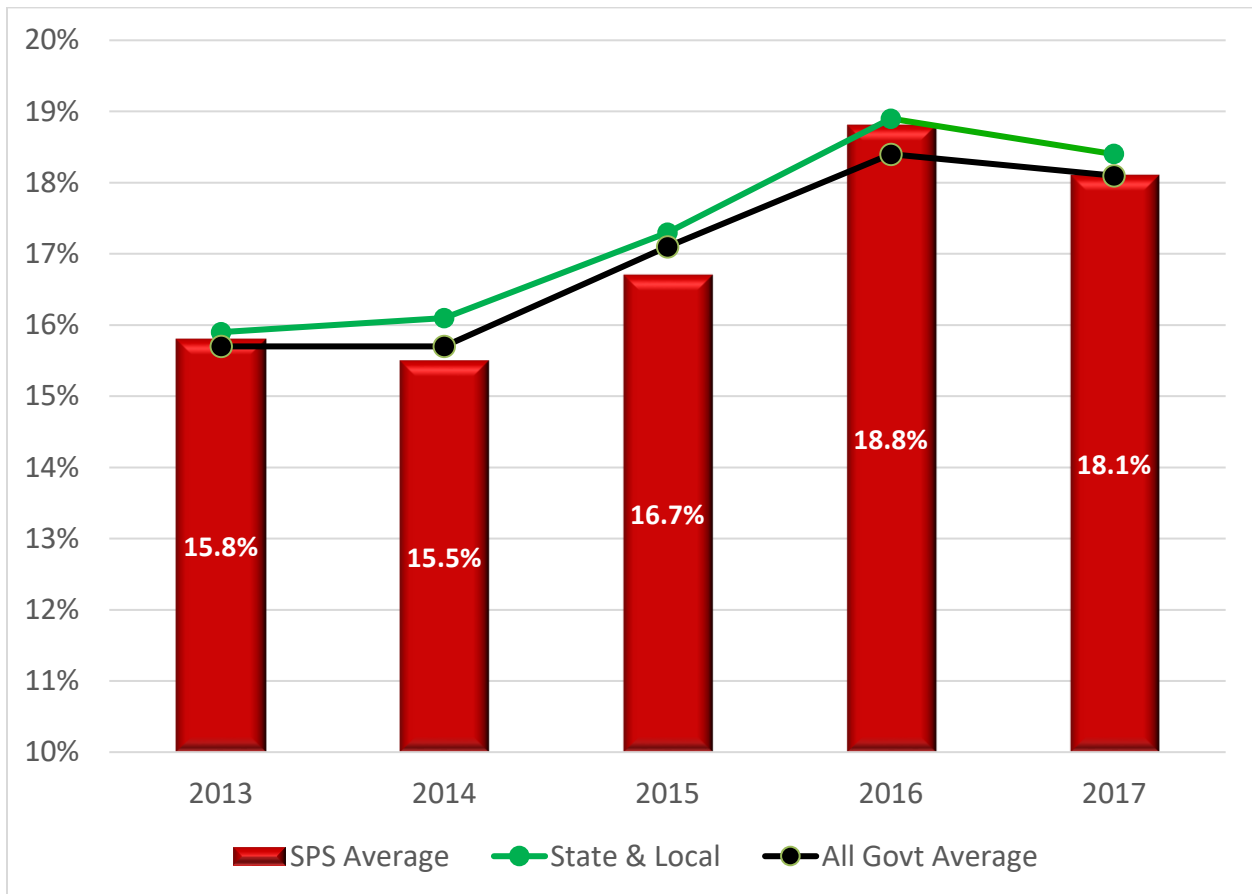
¹⁰ 5% Retention Payments were not added to base salary and were authorized for 19 pay periods in FY 2013.

¹¹ 5% increase was added to base salary for uncovered employees previously receiving the 5% Retention Payments.

Turnover Rates

The turnover rate decreased in FY 2017 from 18.8% to 18.1%, following the same trend in public sector benchmarks. The differences between public sector benchmarks and state employees has narrowed over the past two years.

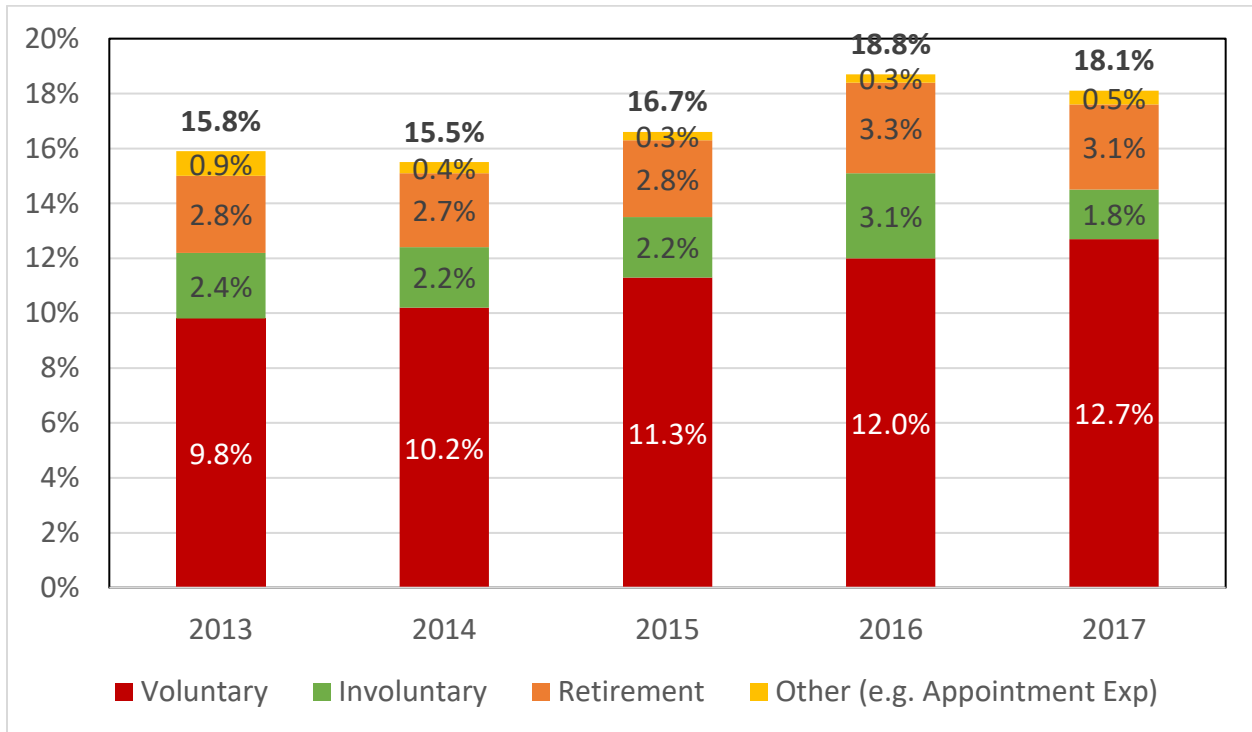
Figure 2¹²
Turnover Rates – Arizona Compared to Benchmarks – FY 2013 to FY 2017



¹² Comparative data from the Bureau of Labor Statistics, U.S. Department of Labor, seasonally adjusted turnover rates. State and Local includes state and local government entities in the 50 states and the District of Columbia. All Government includes federal, state, and local government entities in the 50 states and the District of Columbia.

While overall turnover decreased in FY 2017, the percentage of employees separating voluntarily increased slightly from FY 2016 to FY 2017. Separation due to retirement continues to remain higher than in previous years. Most notable is the reduction in involuntary separations.

Figure 3¹³
Turnover Rates by Type of Separation – FY 2013 to FY 2017

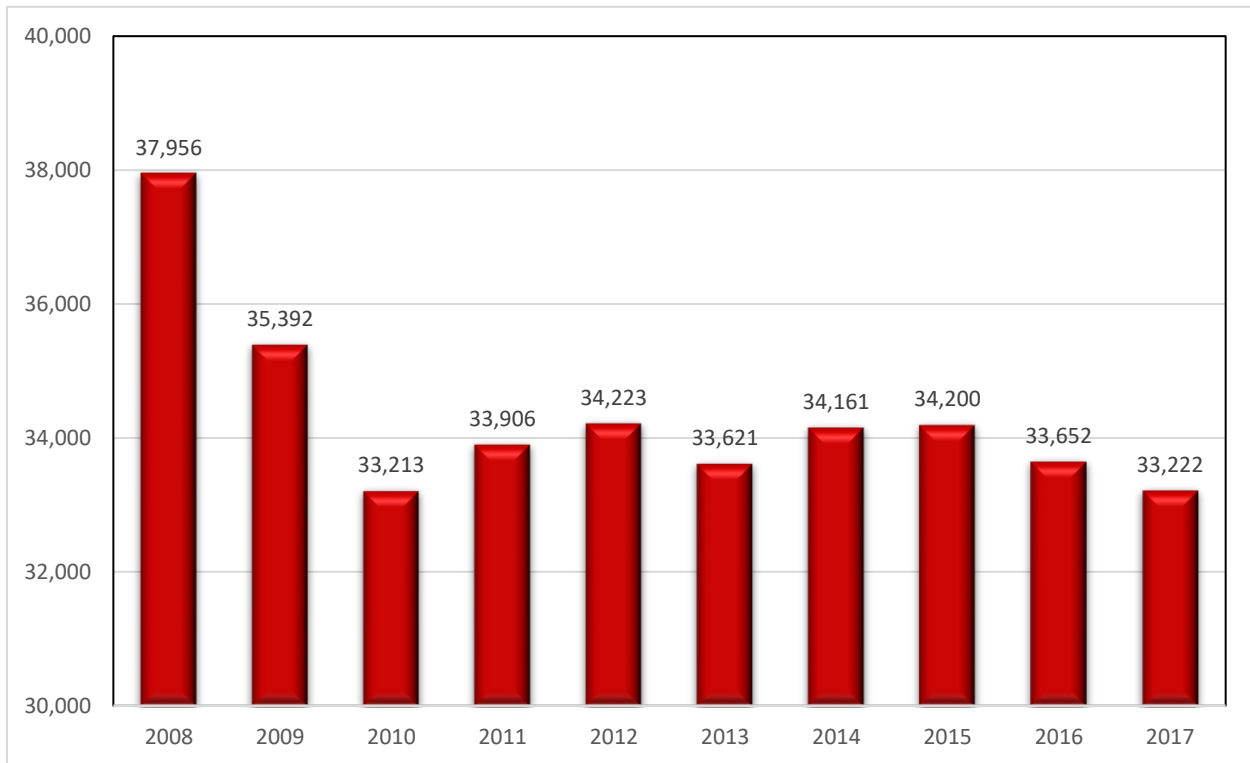


¹³ Table 3.2 – Turnover Rates by Type of Separation. Fiscal Year 2013 – 2017. State of Arizona Workforce Report. 2017.

Reduction in Total Size of Government

The total size of State government was reduced dramatically during the years from 2008 to 2010, as the State managed one of the worst fiscal crises in the nation. During those years, reductions in force and layoffs occurred in most agencies, and a hiring freeze was implemented that ensured further reductions through attrition. Since that time, workforce levels have varied less than 2% per year. In FY 2017, the total size of the workforce was 33,222, which represents a 1.3% reduction from the prior year, and a 14.3% reduction from the FY2008 workforce.

Figure 4
Employee Headcount – Arizona State Personnel System¹⁴

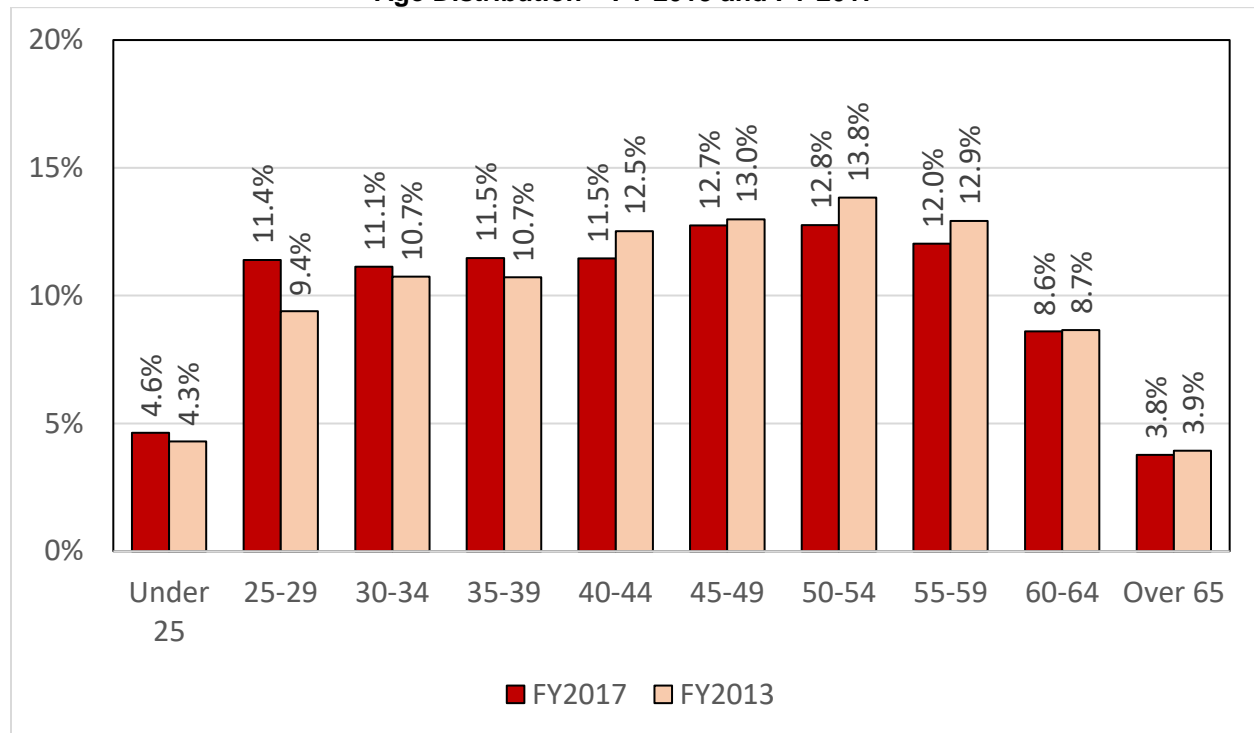


¹⁴ Figure B – State Personnel System Employee Headcount. Fiscal Year 2008 – 2017. State of Arizona Workforce Report. 2017. Although the State Personnel System was not established until FY 2014, headcount numbers in the chart for prior fiscal years reflect the same agencies that are now include in the State Personnel System to provide consist analysis over time.

Average Age of the Workforce

In FY 2017 the average age of a State employee was 44.6 years of age, and the largest age group was in the 50-54 age group. Compared with the age distribution from five years ago, there is a larger percentage of the workforce in those less than 40 years of age. Attracting entry-level talent is important and the State will need to continue to maintain market competitiveness at that level and for those will high levels of experience and expertise to retain the highly proficient workers holding institutional knowledge.

Figure 5
Age Distribution – FY 2013 and FY 2017¹⁵



Retirement Rates and Projections¹⁶

An analysis of employees that meet the criteria for normal retirement in the State agencies with at least 50 employees revealed the following:

- Six agencies are projected to have at least 20% of their workforce meet criteria for retirement in the current fiscal year
- Twenty-six agencies are projected to have at least 25% of their workforce meet criteria for retirement within the next five years
- There are nine agencies that are estimated to have over one-third (33.3%) of their current workforce meet criteria for retirement in five years

Overall, considering the entire workforce, nearly 26% of the workforce is estimated to meet criteria for retirement within the next five years. There is a high percentage of the workforce that either currently meets, or will soon meet the criteria to retire. These facts highlight and reinforce the need to become and remain competitive in the labor market.

¹⁵ Table 2.2 – Age Distribution of SPS Employees. Fiscal Year 2013 and 2017.

¹⁶ Table 3.9 – Employees Meeting Retirement Criteria. Fiscal Year 2017 – 2021. Projected rates of employees that meet criteria for retirement is based on years of service and age criteria for normal retirement from the Arizona State Retirement System and the Public Safety Personnel Retirement System; calculations do not factor in opportunities for early retirement, or those that may have already retired and returned to the workforce.

Current Environment – Competitive Job Market

Market Movement

The job market is constantly moving, and the State’s market position must continually be analyzed to assess the competitive position of the State with respect to the market. Market salaries are influenced by the overall economy at the national and local levels as well as the relative demand for a particular skill or job family.

Figure 6
Actual and Projected Base Salary Increases¹⁷

Reference	2016 Actual	2017 Actual	2018 Projected
National - Korn Ferry Hay Group	2.7%	2.8%	2.8%
National - WorldatWork	3.0%	3.0%	3.1%
National - Economic Research Institute	3.0%	3.1%	3.2%
Local (Private Sector Only) AZ Compensation Survey	2.7%	2.5%	2.8%
Local (Public & Private) AZ Compensation Survey	2.3%	2.2%	2.3%
Local (Public Sector Only) AZ Compensation Survey	1.6%	1.5%	1.1%
State of Arizona	0%	0%	TBD

Distance to Market

Every year the State conducts a formal analysis of market pricing jobs to assess the relative position of State salaries with the external job market. The most recent analysis of market competitiveness suggests the market exceeds State employee base salaries by an estimated 13.6%.

The State’s workforce is changing and evolving to keep pace with business and the marketplace. As shown previously (Fig 2), the turnover rate is comparable to other public sector benchmarks. While there is certainly more gains to be realized, especially in the area of voluntary separations, this information suggests the State is aligned with other organizations. Further evidence suggesting the change in the workforce is illustrated in Figure 5. Previously the State appeared to be heavily skewed toward older age workers, whereas the current workforce shows a much less pronounced curve and a more even distribution of workers across all age bands. In order to attract and hire the next generation of workers, competitive wages are necessary. Furthermore, the overall reduction in the size of the workforce (Fig. 4) shows the State is nearly as compact as it was in 2010. Moving forward, many agencies are embracing the strategy of fewer, more highly qualified workers. Thus it is not surprising to see the State moving closer to market in base compensation.

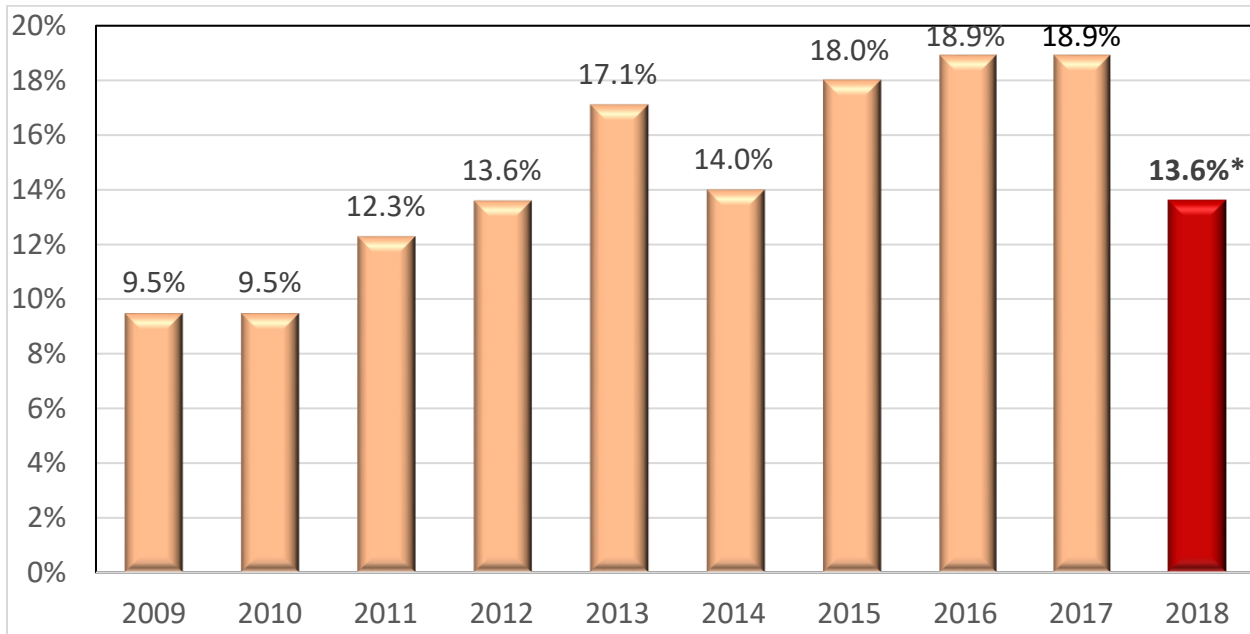
Matching jobs to market benchmarks requires skill and a certain level of judgement as analysts compare jobs in differing environments attempting to closely match skill requirements for the various positions in the State. Changes in salary survey availability, number of valid job matches, technology assistance and standard processes will result in slight year over year variances in estimates of market competitiveness. This year’s market review was conducted by Mercer, the world’s largest human resources consulting firm, using different market sources and adopting a more conservative matching process than in prior years.

In the future, the State will use a consistent suite of salary surveys and an automated software application that will provide better information to customers and stakeholders, and more transparency in the market matching process. As technology has improved over the years, we

¹⁷ National data from Korn Ferry Hay, Economic Research Institute, and WorldatWork websites; Arizona data from 2017 Arizona Compensation Survey.

are able to provide better analytics to provide more meaningful compensation information to decision makers at every level of the enterprise.

Figure 7
Percent Needed to Get to Market¹⁸



Recent and Future Changes to State Government Workforce

Classification System

The current classification system has been in place for several decades, despite multiple attempts to overhaul and revise it. Over the years, it has evolved to become a means of addressing compensation issues when typical market movement in salary ranges and base pay were not available. Several practices have become the norm that result in using the classification system to provide salary increases to certain small groups of employees that are not available to all State employees. Maintaining this cumbersome system furthers pay inequity within and among agencies, as well as creating burdensome administration practices.

Beginning in FY 2014, small pockets of classification reform have been implemented to foster market competitiveness and create meaningful career paths for employees in those job families. In FY 2017, a national consultant was retained to assist in a system-wide classification reform project. The consultancy portion of this project has been completed and the Human Resources Division is reviewing their results and recommendations. The goal of the project will result in a consolidated, competitive and internally equitable classification system. Employees will be allocated to the appropriate job classification, within a job family that allows for clear line of sight related to career paths within their agency and statewide.

¹⁸ Percent Needed to Get to Market is based on a suite of compensation surveys, including the Arizona Compensation Survey (previously referred to as the Joint Governmental Salary Survey). Average State Employee Salaries are based on employees in the State Personnel System calculated at the beginning of the fiscal year (July 1).

*2018 data reflects a change in methodology with a third-party consultant providing market matches for benchmark jobs.

Strategic Workforce Planning

With the realities of a multi-generational workforce, it is imperative that agencies continue and strengthen their work in Strategic Workforce Planning. Recruiting and retention of Millennials and Gen X generational groups needs to be an area of focus as critical, pivotal roles will need to be maintained as Baby Boomers and the last of the Silent Generation workers plan for retirement. It is critical that the State maintain the knowledge obtained by the retiring workforce to continue successfully serving the citizens of Arizona.

Mercer's 2016/2017 US Compensation Policies and Practices Survey Results reveal that the issues of generational workforces are not unique to the State. Of companies surveyed, 93% have challenges in attracting Millennials and 57% of those same companies have issues retaining employees from that same generation. Two factors continue to be identified as critical needs: competitive salaries and career paths.

Conclusion

In the past, this Advisory Recommendation has identified classification and job families that were significantly behind the job market as the primary justification for requesting additional funding from the Legislature. That strategy minimizes agency flexibility and assumes that all agencies have the same strategic goals and needs.

Classification reform will result in more competitive salary ranges and better opportunities for career paths for our workforce. This initiative when combined with strategic workforce planning are expected to be strategic drivers within the people systems of the Arizona Management System. Focus on these areas, combined with the already implemented agency flexibility with compensation strategies will combine to help strengthen our workforce.

Classification reform will realign grades and salary ranges that are more reflective of market conditions. This will provide agency leadership with the tools and information needed to strategically target their resources to the business functions that provide the highest return for their investment.

Recommendation

As agencies are provided increased flexibility to manage employee salaries, and as classification reform results in more competitive salary ranges, the Department recommends deferring any legislative salary increases at this time.

