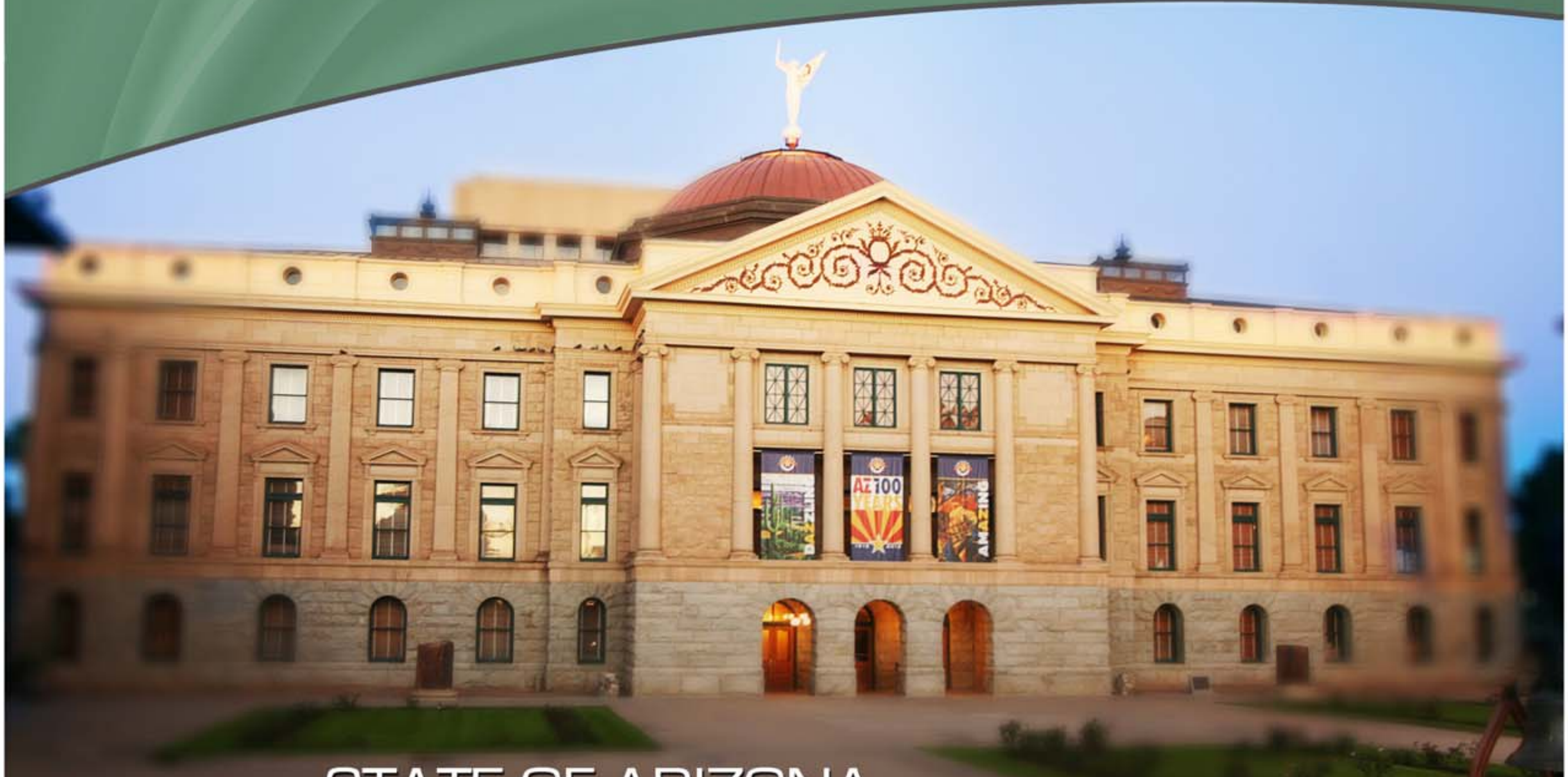
ADOA-HRD



# STATE OF ARIZONA
# ADVISORY RECOMMENDATION

Janice K. Brewer
Governor

2014

Brian C. McNeil, Director
Department of Administration

**Janice K. Brewer**
**Governor**

**Brian C. McNeil**
**Director**

# ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

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September 2014

The Honorable Janice K. Brewer
Governor, State of Arizona
The Honorable Andy Biggs
President, Arizona State Senate
The Honorable Andy Tobin
Speaker, Arizona House of Representatives
1700 West Washington
Phoenix, Arizona 85007

Dear Governor Brewer, President Biggs, and Speaker Tobin:

Pursuant to Arizona Revised Statutes § 41-751, the 2014 Advisory Recommendation provides information concerning the compensation of State employees and an objective assessment of the job market. This Advisory Recommendation provides important information needed when making decisions affecting Arizona State government and its employees' compensation.

State salaries are 18% off market salaries. In addition, in FY 2015, the market is conservatively estimated to move by 2.5%. The cost to bring State salaries up to the prevailing job market would cost approximately $272.5M. Even funding a 2.5% increase to retain the State's current salary level in comparison to market would require $37.8M. Recognizing that funding these changes is not a realistic exercise, the State should nevertheless consider providing *some* funding for State salaries.

The recommendation that follows is a conservative strategy that provides very modest increases for the classifications that range from 19.6% off market to 49.1% off market. Rather than providing an "across the board" increase, we believe that limited funds will best be used by strategically targeting those classification series that are furthest off the market. This proposal may not significantly close the overall gap between State salaries and the job market, but it should prevent the State from falling further behind in a number of key job classifications.

In summary, we recommend funding and allocating agencies with $10.6M ($3.95M in General Fund and $6.65M in Federal and other funds) targeted toward specific classifications that are the furthest off the market, have experienced significant turnover, and are high profile or of critical importance. While still a significant increase, we believe this strategy will generate a substantial return in improvements to recruiting and retention.

Sincerely,

Brian C. McNeil
Director

# 2014 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 fund agencies for market adjustments for critical classifications.

> *This report reflects the current status of Arizona State employee compensation as it relates to market conditions at the end of Fiscal Year 2014. The report is provided as a resource to guide statewide budget considerations during the preparation of the Fiscal Year 2016 budget.*

**Current Environment – State Government**

History of Salary Adjustments

**Figure 1**
**History of the State's Compensation Adjustments**[1]

| 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 | N/A | -0- | -0- | No |

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[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.

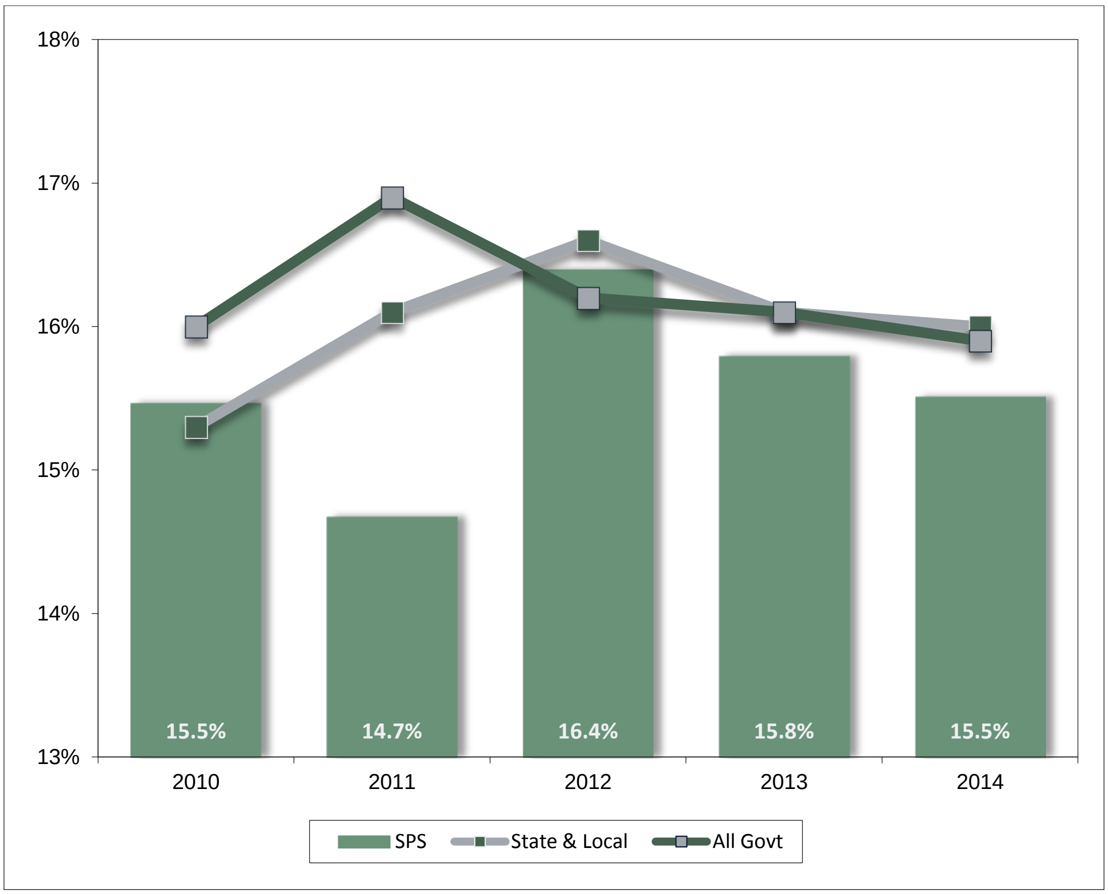
[9] Represents a (2.75)% performance pay reduction intended to eliminate the FY 2007 and FY 2008 Performance Adjustments.

[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 for both covered and at-will uncovered employees decreased in FY 2014 from 15.8% to 15.5%. The 5-year average rate of turnover was 15.6%. The rate in 2012 was elevated due in part to the outsourcing of the Department of Corrections Health Care unit. If this outsourcing was removed from the calculations, the total separation rate would have been 14.9%. The average separation rate for all State Personnel System agencies has been lower than benchmarks since 2010.

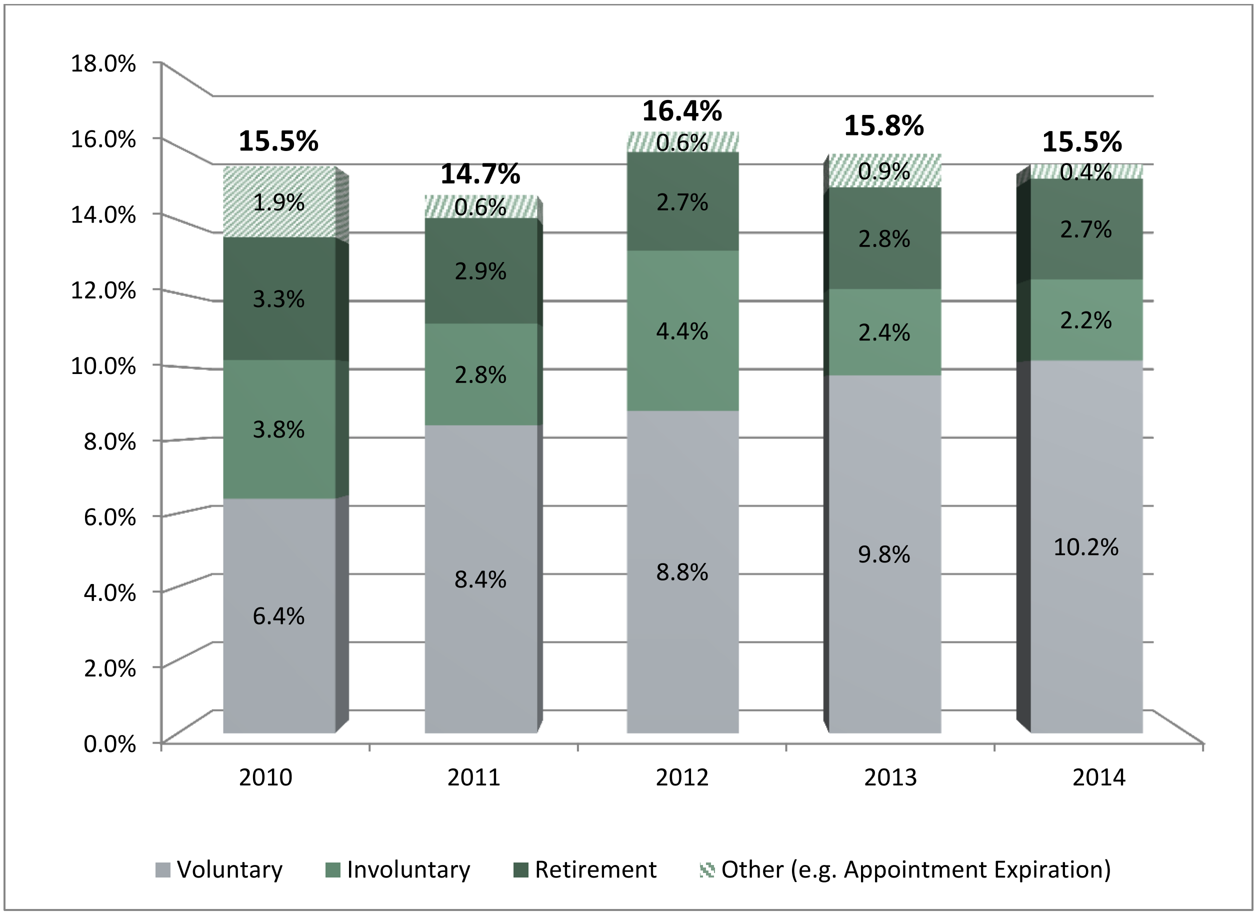
**Figure 2**[12]
**Turnover Rates – Arizona Compared to Benchmarks – FY 2010 to FY 2014**




[12] Table 2.1 – Turnover Rates – Arizona Compared to Benchmarks. Fiscal Year 2010 – 2014. State of Arizona Workforce Report. 2014.

More indicative of the need for the State to improve its competitive position in the market place is the overall increase in the number of voluntary separations from the State. In FY 2014, over 10% of the workforce voluntarily separated. Figure 3 illustrates the consistent increase in the number of voluntary separations every year for the past four years, providing further evidence that as the economy improves, more employees are choosing employers other than the State. While overall turnover may have decreased between FY 2013 and FY 2014, the increase in voluntary separations in each year since FY 2010 is very concerning.

**Figure 3[13]**
**Turnover Rates by Type of Separation – FY 2010 to FY 2014**

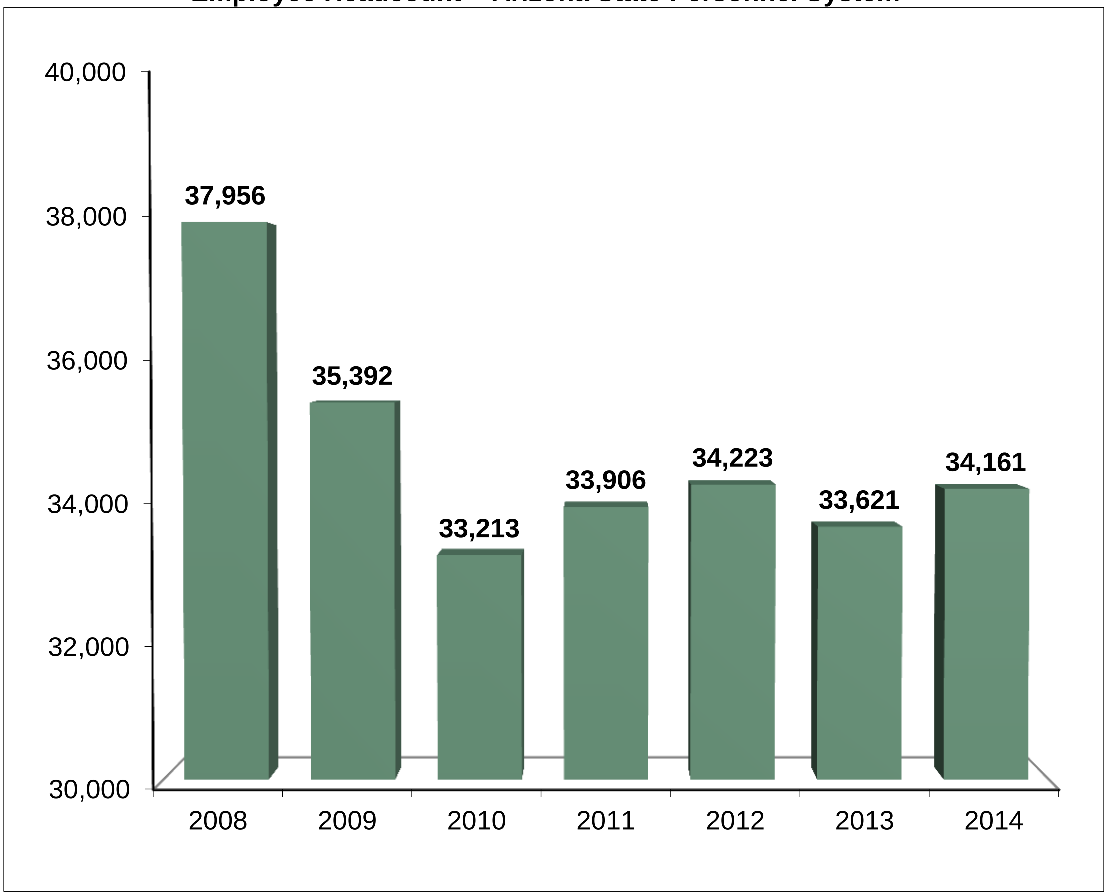



[13] Table 2.2 – Turnover Rates by Type of Separation. Fiscal Year 2010 – 2014. State of Arizona Workforce Report. 2014.

Reduction in Total Size of Government

The total size of State government was dramatically reduced 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. Although there were slight increases in the size of the workforce in 2011 and 2012, total staffing levels appear to be leveling off and the size of the workforce increased slightly (1.6%) in FY 2014, due in large part to increased staffing at the Department of Economic Security (including a portion of the agency that was separated to become an independent agency, the new Department of Child Safety.) In FY 2014 the total size of the workforce was 34,161, which represents a 10% reduction from the size of the workforce in FY 2008.

**Figure 4**
**Employee Headcount – Arizona State Personnel System**[14]

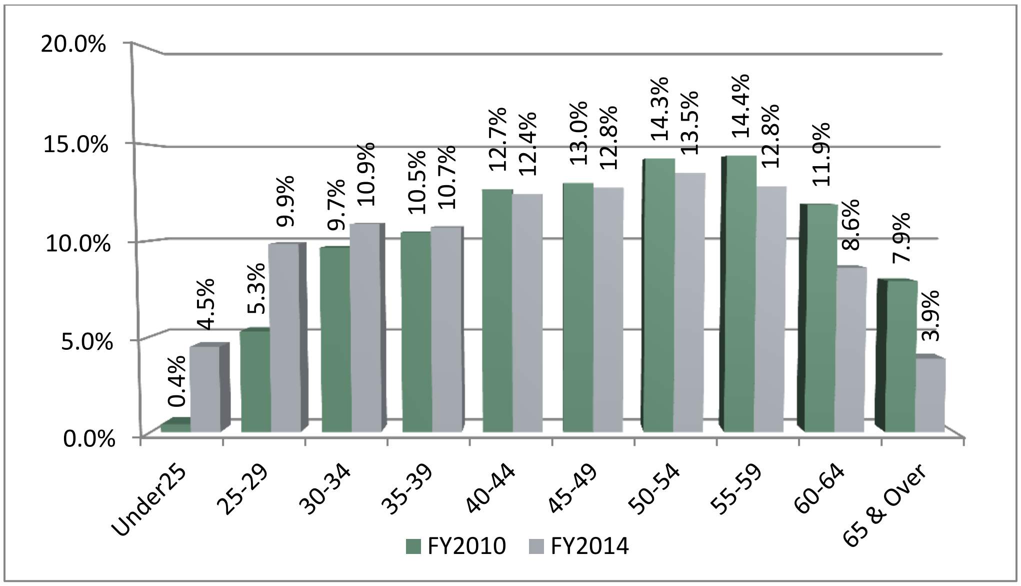



[14] Figure B – State Personnel System Employee Headcount. Fiscal Year 2008 – 2014. State of Arizona Workforce Report. 2014. Although the State Personnel System was not established until FY 2014, headcount numbers in the chart for prior fiscal years reflect the same agencies that are now include in the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

Average Age of the Workforce

In FY 2014 the average age of a State employee was 45.2 years of age, and the largest age group was in the 50-54 age group. Compared with the age distribution from five years ago, the employee population under age 35 has increased by 68.8%. As a proportion of the workforce, the age group over 65 was 4.0% lower in FY 2014. These changes have the overall effect of shifting the curve of age distribution to the younger age categories compared with FY 2010.

**Figure 5**
**Age Distribution – FY 2010 and FY 2014[15]**




Retirement Rates and Projections[16]

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

- Three agencies are projected to have at least 25% of their workforce meet criteria for retirement in the current fiscal year
- Twenty-seven agencies are projected to have at least 25% of their workforce meet criteria for retirement within the next five years
- There are five agencies that are estimated to have over 40% of their current workforce meet criteria for retirement in five years

Overall, considering the entire workforce, 27% 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 competitive in the labor market.

[15] Table 4.2 – Age Distribution of SPS Employees. Fiscal Year 2010 and 2014. State of Arizona Workforce Report. 2014.
[16] Table 2.10 – Employees Meeting Retirement Criteria. Fiscal Year 2015 – 2019. State of Arizona Workforce Report. 2014. 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.

## Changes to State Government Workforce

Personnel Reform

In May 2012, Governor Brewer signed significant personnel reform into law, modernizing the way in which State government manages, hires, and separates employees. This was one of the most extensive changes to Arizona's governmental infrastructure which began to take effect in FY 2013. With this change, the following key developments were implemented:

- Consolidation of Personnel Systems

  At the heart of personnel reform legislation was the development of a new personnel system. Through consolidating several different personnel systems, implementing consistent human resources practices, and eliminating unnecessary redundancies, significant efficiencies are being realized.

- Transition to At-Will

  At the time of implementation of personnel reform, a number of employees were transitioned from a covered status to an at-will uncovered status. This change included all new hires, all supervisors, all employees in a grade 19 or higher position, all employees in the attorney salary schedule, all employees in the information technology salary schedule, all employees voluntarily accepting a change in assignment, and all employees that otherwise volunteer to transition to at-will uncovered. Nearly 40% of the employees that were eligible, volunteered to become at-will uncovered. As a result, at the end of FY 2014, over 68% of the workforce is uncovered (over 83% when excluding Correctional Officers and Community Corrections Officers that are required to remain covered).

  Collectively, consolidating personnel systems, changes to the personnel rules and policies, and transitioning the workforce to an at-will uncovered status, will result in increased productivity, eliminating unnecessary bureaucratic processes, and ultimately saving taxpayers money. The system is based on a model that has been standard practice in the private sector. One of the most meaningful and significant aspects of the system is the shift in the culture of the workforce toward pay for performance.

- Performance Management

  An integral part of the reform initiative is the system by which the State will identify top performing employees. The previous performance management system was considered by many to be ineffective, inefficient, and burdensome. Furthermore, only covered employees (79% of the workforce in FY2012) were required to have an annual performance management review with their supervisor. The new performance management system applies to the remaining covered employees as well as most uncovered employees. Over 99.1% of the workforce is now subject to performance evaluation on a consistent framework of competencies. Some competencies are uniform across the entire State, and others are specifically defined by each agency. All agencies will have evaluated their employees during FY 2014.

  One of the goals of personnel reform is to attract top performers to the State, and to retain the top performers that are currently in the workforce. Given that the size of the overall workforce has been significantly reduced (Figure 4), future success depends on having a highly engaged, high performing team of employees. Compensating these employees appropriately must be a high priority for the State in order to attract and retain top talent in an improving economy.

- Incentive Payments

  The use of one-time incentives to recognize and reward high performing employees was a bold strategy for the State. Research was conducted into the compensation practices of employers of choice and selected strategies were identified as suitable for the State given appropriate controls and limitations.

  In FY2013, the State began the practice of allowing agencies to use up to 1% of their personal services base funding to implement a program of one-time incentive payments for top performing employees. Agencies wishing to participate in this program were required to submit a proposed plan to the Department of Administration for review and approval prior to implementing any incentive payments to employees. Tight controls were established to ensure incentives were only provided to employees that met eligibility criteria, and incentive amounts were limited depending upon the strategy.

  The program was successful and agency directors overwhelmingly lauded the opportunity to recognize and reward their best employees. Their only complaint was the severe limitation of only 1% of the agency's personal services base did not provide enough resources to meet the needs of the agency. In FY2014, the budgetary limit was increased to 2% of the agency's personal services base. More agencies participated in the program than in the previous year, and early indications from the agencies again indicate strong support and appreciation for these new compensation strategies. This approach has been instrumental in mitigating some of the market pressures and impacts from the State's salaries lagging behind the prevailing job market.

Classification System

The current classification system has been in place for several decades, in spite of several past attempts to overhaul and revise it. Over the course of years, it has gradually been changed to become a means of addressing compensation issues. Practices such as establishing "special recruitment rates," developing special salary schedules, and delineating classifications into narrow bands as an artificial means of providing additional "promotional" opportunities, all have served to increase the bureaucracy and cumbersome nature of managing within the existing classification system.

Moving forward, the classification system will be improved through establishing classifications based on reliable, industry-accepted occupational information and job groups. This process began in fiscal year 2014 with the information technology classifications. Changes will allow market salary ranges for each classification, and employee performance will be the driving force to move individual salaries toward the market rate. Toward that end, the State is participating in more salary surveys than ever before, ensuring solid and reliable market pricing for the majority of positions in State government.

Collectively, these strategies are expected to assist the State Personnel System to be competitive with other employers.

## 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.

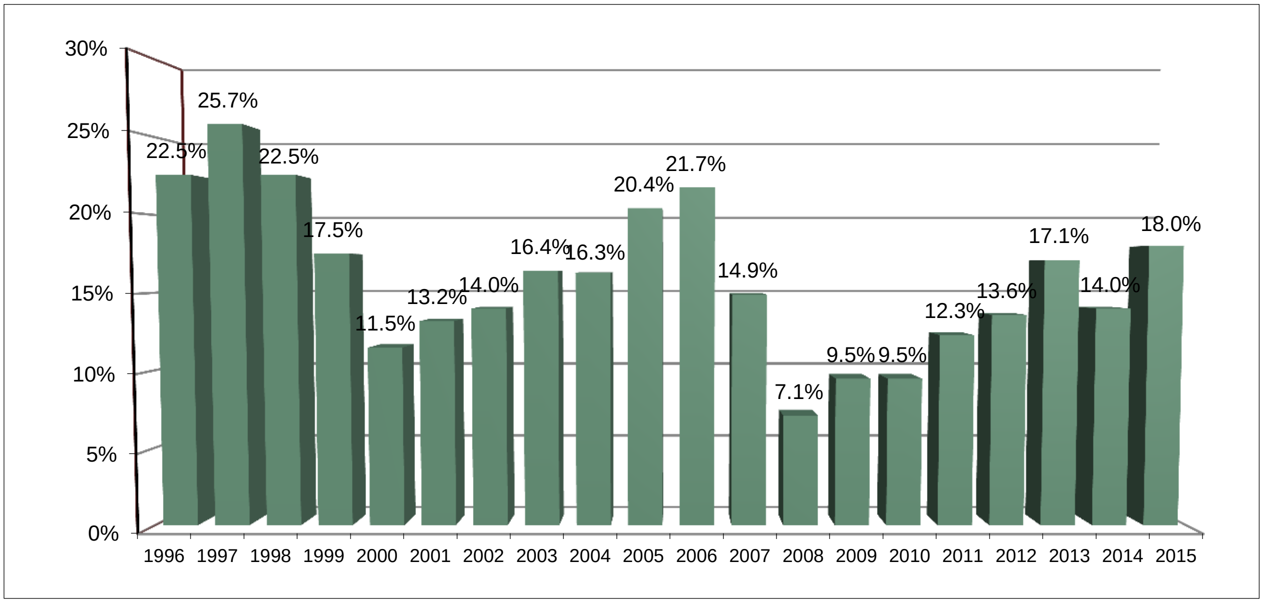
**Figure 6**
**Actual and Projected Base Salary Increases**[17]

| Reference | 2013 Actual | 2014 Actual | 2015 Projected |
|---|---|---|---|
| National - Hay | 3.0% | 3.0% | 3.0% |
| National - Mercer | 2.8% | 2.9% | 3.0% |
| National - WorldatWork | 2.9% | 3.0% | 3.1% |
| Local (Private Sector Only) AZ Compensation Survey | 2.7% | 2.7% | 2.8% |
| Local (Public & Private) AZ Compensation Survey | 2.3% | 2.7% | 2.5% |
| Local (Public Sector Only) AZ Compensation Survey | 1.1% | 2.7% | 1.5% |
| **State of Arizona** | **2.5%**[18] | **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 18.0%.

**Figure 7**
**Percent Needed to Get to Market**[19]

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[17] National data from Hay, Mercer, and WorldatWork websites; Arizona data from 2014 Arizona Compensation Survey.
[18] Approximately 50% of the workforce received the 5% retention payment increase to base salary
[19] 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).

Some agencies have not been able to fill vacant positions unless they offer a starting salary at rates higher than many of the current incumbent employees. This creates a difficult situation for agencies attempting to manage internal pay equity with salaries that are competitive. This difficulty is only expected to be exacerbated by the continued movement of the job market (Figure 6), while State salaries remain essentially unchanged.

Using the most conservative projections for market movement in FY 2015 from Table 6, a 2.5% salary increase would be required in order to remain at the current position of 18% behind the market.

Critical Classifications

The job market is estimated to exceed the average State employee salary by 18.0%; however, there are employees in some classifications that are much further behind than others, as much as 50%, 60%, even 80%. Currently the State maintains a classification system with nearly 2,700 different classifications that have active employees assigned to a position within the classification. One of the major initiatives that will be implemented in the near future is the consolidation of classifications and establishment of salary ranges that are benchmarked to the job market. Although this process is not completed, an initial analysis of classification and market position reveals that many job families are significantly further off the market than the overall average. Many of these job families have also experienced turnover rates that exceed the statewide average.

The following table lists the job families that are recommended for salary adjustments due to distance from market, turnover, and other critical needs.

**Figure 8**
**List of selected classifications with benchmarks and estimated distance to market and turnover**

| Classification Series | Number of Employees | Estimated % To Market | Estimated Turnover |
|---|---|---|---|
| Audit | 200 | 49.1% | 11.9% |
| Occupational Safety | 18 | 44.4% | 16.3% |
| Statistical Analysis | 19 | 38.1% | 20.0% |
| Budget Analysis | 44 | 36.1% | 12.9% |
| Contract Management | 79 | 35.9% | 10.7% |
| Hydrology | 61 | 32.6% | 10.4% |
| Legal Support | 138 | 30.1% | 11.8% |
| IT-Info Security | 53 | 30.0% | 12.6% |
| Accounting | 280 | 28.3% | 10.8% |
| Skilled Trades | 92 | 27.5% | 23.5% |
| IT-Business Analysis | 90 | 27.4% | 12.6% |
| IT-Mainframe | 65 | 27.4% | 12.6% |
| Procurement | 162 | 26.8% | 12.1% |

## Other Classifications

In addition to the classification families listed in Figure 8, there are several other classification families that are also significantly behind the prevailing job market. Although these classes have not been included in the recommendation for funding this year due to factors such as low turnover and limited funding availability, it is important to recognize the job families are considerably behind the market.

The following table lists the job families that have not been included in the recommendation for salary adjustments.

**Figure 9**
**List of selected classifications with benchmarks and estimated distance to market and turnover**

| Classification Series | Number of Employees | Estimated % To Market | Estimated Turnover |
|---|---|---|---|
| Chaplain | 38 | 36.3% | 6.0% |
| Administrative Support | 2,044 | 33.6% | 15.6% |
| Equipment Operation | 34 | 30.0% | 4.8% |
| Social Services | 3,835 | 29.1% | 19.0% |
| Warehouse/Storage/Supplies | 37 | 26.0% | 19.4% |
| Environmental Programs | 158 | 25.8% | 16.2% |
| IT-Systems Architect | 336 | 25.7% | 12.6% |
| Legal | 465 | 25.3% | 13.9% |
| General Labor | 11 | 24.4% | 0.0% |
| Elevator Inspection | 11 | 24.1% | 9.1% |
| Construction/Maintenance | 205 | 23.9% | 14.8% |
| IT-Geographic Info Sys | 36 | 23.8% | 12.6% |
| Epidemiology | 23 | 22.8% | 26.7% |
| IT-Database | 60 | 22.7% | 12.6% |
| Food Service | 68 | 21.3% | 36.7% |
| IT-Applications Development | 379 | 20.0% | 12.6% |
| Fiscal Services | 321 | 19.6% | 14.4% |

**Conclusion**

As evident in Figure 7, the market competitiveness of State salaries has fluctuated over the years. As the economy continues to improve at both the national and local levels, it is anticipated that voluntary separations will continue to increase driving an overall increase in turnover rates, and creating more difficulty for agencies to attract the talent that the State needs.

In FY2013 (specifically in October 2012), uncovered employees began receiving 5% critical retention payments, which were subsequently converted to base pay. However, there have been no funded salary increases since that time. While agencies have been able to make some base salary adjustments and provide some one-time performance pay incentives, those actions have been almost exclusively funded under existing agency budgets. As illustrated in Table 6, the market continues to move and State base salaries have fallen further behind the market.

In order to close the gap to bring State salaries within 5%, an estimated $196.8 million would be required. While this strategy would dramatically improve the State's position relative to the market, it isn't realistic given the economic realities of the State's budget. In fact, even providing enough funds for the State to match the projected market movement in FY 2015 would require over $37.8M; and that would be just enough to maintain the State's position at 18% behind the market. Agencies may have the opportunity to address individual employees' salaries through a limited set of compensation strategies, or in some cases pursue market adjustments for specific classifications unique to the agency. These actions should be viewed as positive steps, however, they should not be relied upon to resolve infrastructure issues within the State's compensation framework.

Given the current and anticipated economic conditions, we are recommending a restrained alternative. It limits funding to the classification series that are greater than 18% off the market. Therefore, an individual classification may be more than 18% off the market, but if the weighted average of the entire series is not greater than 18% off the market, it was not given further consideration. We then calculated the estimated funding necessary to bring these employees' salaries not up to market, but up to the average of other State employees, namely within 18% of market. We also took into consideration those classification series that were high profile and of critical importance.

By using this approach, we can generate a conservative recommendation that minimizes the degradation of the State's current market position while addressing those classifications that are further off market than the other classifications in the State. The following classifications are recommended due to factors mentioned above: high profile, critical importance, distance from market and turnover:

- Accounting
- Audit
- Budget Analysis
- Contract Management
- Hydrology
- IT-Business Analysis
- IT-Information Security
- IT-Mainframe
- Legal Support
- Occupational Safety
- Procurement
- Skilled Trades
- Statistical Analysis

**Recommendation**

Recognizing the multiple demands on the state budget, a conservative recommendation focuses on maintaining the State's position relative to the job market. It targets limited resources toward the classification series that are furthest off the market.

- Funding for Critical Classification Series

  In order to address the classification series that are furthest off market, have experienced high turnover, and/or have a high impact on State government operations, we recommend that each agency be appropriated and funded sufficiently to bring employee salaries in the classifications previously identified up to the statewide average of 18% off the market. The Arizona Department of Administration will coordinate with the Governor's Office of Strategic Planning and Budgeting and the Joint Legislative Budget Committee as each classification is reviewed to identify specific funds that are affected.

Total Estimated Funding: **$10,629,694**

| | |
|---|---|
| General Fund (38.0%) | **$3,953,026** |
| Appropriated Fund (26.5%) | **$2,804,044** |
| Non-Appropriated Fund (15.3%) | **$2,003,752** |
| Federal Fund (20.2%) | **$1,868,872** |

Notes: In accordance with A.R.S. § 41-751, this recommendation only addresses active employees in the State Personnel System. This recommendation does not include appropriate budgeting for vacant positions. The following agencies are excluded from this recommendation: Arizona State University, Auditor General, Board of Regents, Cotton Research Council, Court of Appeals, Department of Public Safety, House of Representatives, Joint Legislative Budget Committee, Law Enforcement Merit System, Legislative Council, Northern Arizona University, School for the Deaf and Blind, Senate, Supreme Court, and University of Arizona. Funding estimate based on HRIS base salary, payroll records for the pay period ending June 20, 2014, an estimated variable ERE rate of 21%, and statewide fund allocations from FY 2014.

GREAT SEAL OF THE STATE OF ARIZONA
DITAT DEUS
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