



ADOA



State of Arizona

ADVISORY RECOMMENDATION



2016

Douglas A. Ducey
Governor

Craig C. Brown, Director
Department of Administration



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ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

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September 2016

The Honorable Douglas A. Ducey
Governor, State of Arizona

The Honorable Andy Biggs
President, Arizona State Senate

The Honorable David M. Gowan Sr.
Speaker, Arizona House of Representatives
1700 West Washington
Phoenix, Arizona 85007

Dear Governor Ducey, President Biggs, and Speaker Gowan:

Pursuant to Arizona Revised Statutes § 41-751, the 2016 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.

This year, State salaries are estimated to be 18.9% off market salaries. In addition, in FY 2017, the market is conservatively estimated to move by about 2.5%. The cost to bring State salaries up to the prevailing job market is estimated at about \$271M. Even funding a 2.5% increase to retain the State's current salary level in comparison to market would require \$36.5M.

The recommendation that follows recognizes that agency leadership has been provided increased flexibility to manage employee salaries within the existing classification and compensation system. Furthermore, future expected changes to the classification system will provide more transparency and more competitive salary ranges. Combined with additional tools to assist agencies with strategic workforce planning, it is believed that agencies will have the best resources available to strategically target their greatest needs.

In summary, we recommend deferring any legislative salary increases at this time.

Sincerely,

Craig C. Brown
Director

2016 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 2016. The report is provided as a resource to guide statewide budget considerations during the preparation of the Fiscal Year 2018 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	N/A	-0-	-0-	No

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.

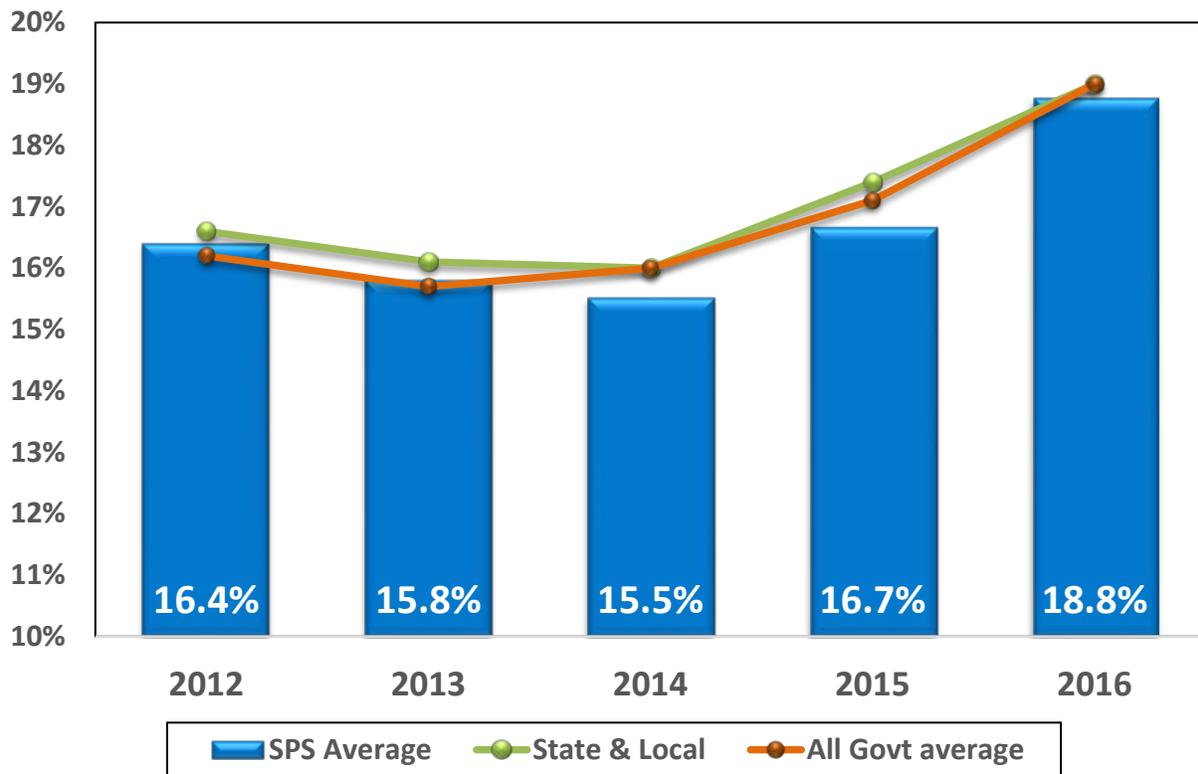
¹⁰ 5% Retention Payments were not added to base salary and were authorized for 19 pay periods in FY 2013.

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

Turnover Rates

The turnover rate for increased in FY 2016 from 16.7% to 18.8%, however, public sector benchmarks also demonstrated a large increase as well. Turnover rates remained lower than public sector benchmarks, yet have followed the same general pattern for the last several years.

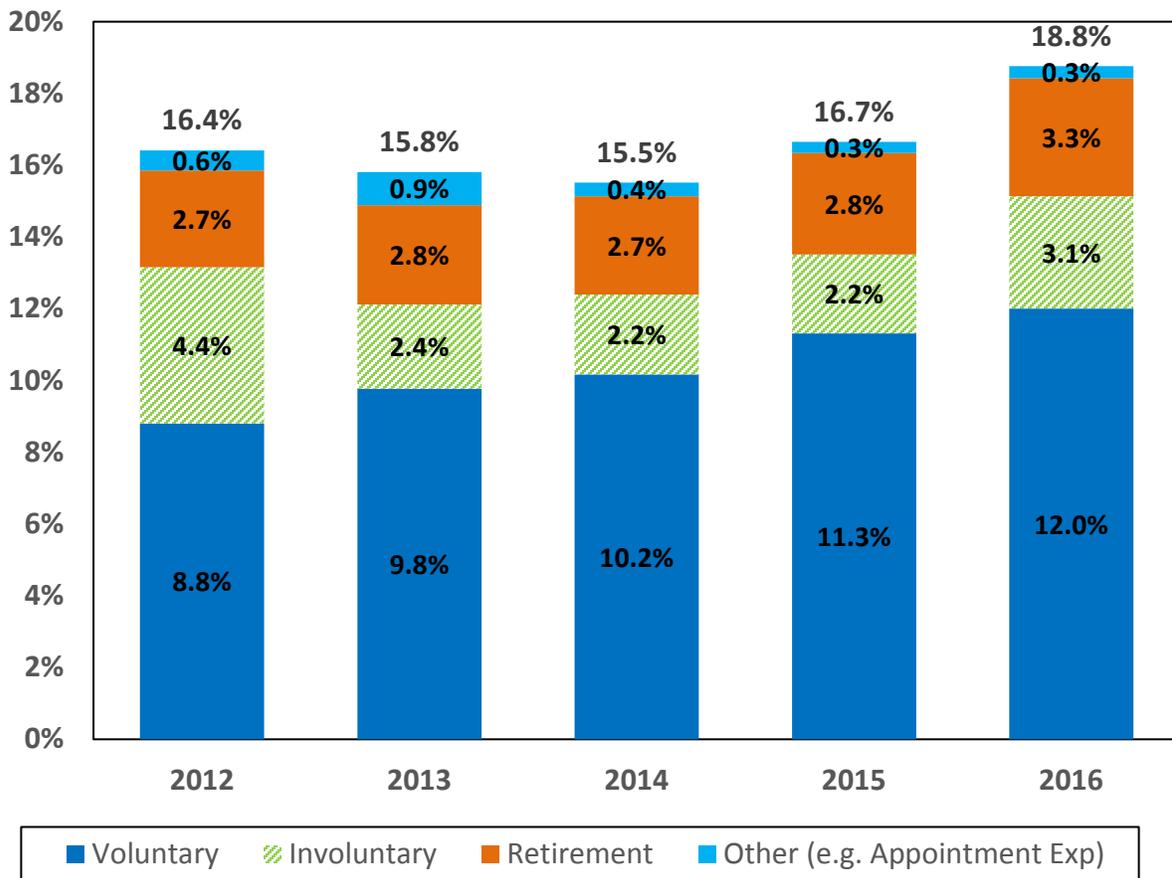
Figure 2¹²
Turnover Rates – Arizona Compared to Benchmarks – FY 2012 to FY 2016



¹² Table 3.1 – Turnover Rates – Arizona Compared to Benchmarks. Fiscal Year 2012 – 2016. State of Arizona Workforce Report. 2016.

All categories of turnover increased from FY 2015 to FY 2016. The largest increase was observed in the category of involuntary separations. Also notable, however, was the percentage of separations due to retirements; this category increased to the highest percentage in recent years.

Figure 3¹³
Turnover Rates by Type of Separation – FY 2012 to FY 2016

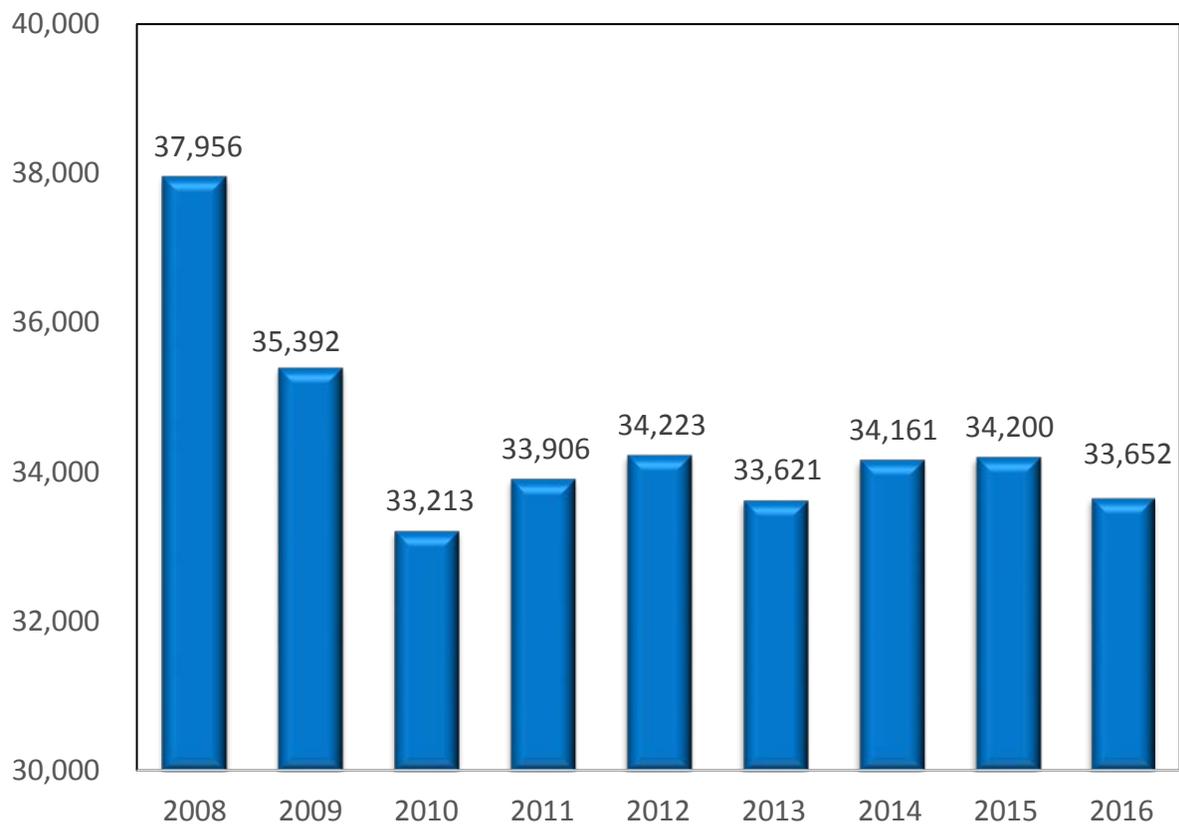


¹³ Table 3.2 – Turnover Rates by Type of Separation. Fiscal Year 2012 – 2016. State of Arizona Workforce Report. 2016.

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. Although there were slight increases in the size of the workforce in 2011 and 2012, total staffing levels appear to have leveled off and the size of the workforce appears to have generally stabilized, fluctuating less than 2% from year to year. In FY 2016 the total size of the workforce was 33,652, which represents a 1.6% reduction from last year and an 11.3% reduction from the size of the workforce in FY 2008.

Figure 4
Employee Headcount – Arizona State Personnel System¹⁴

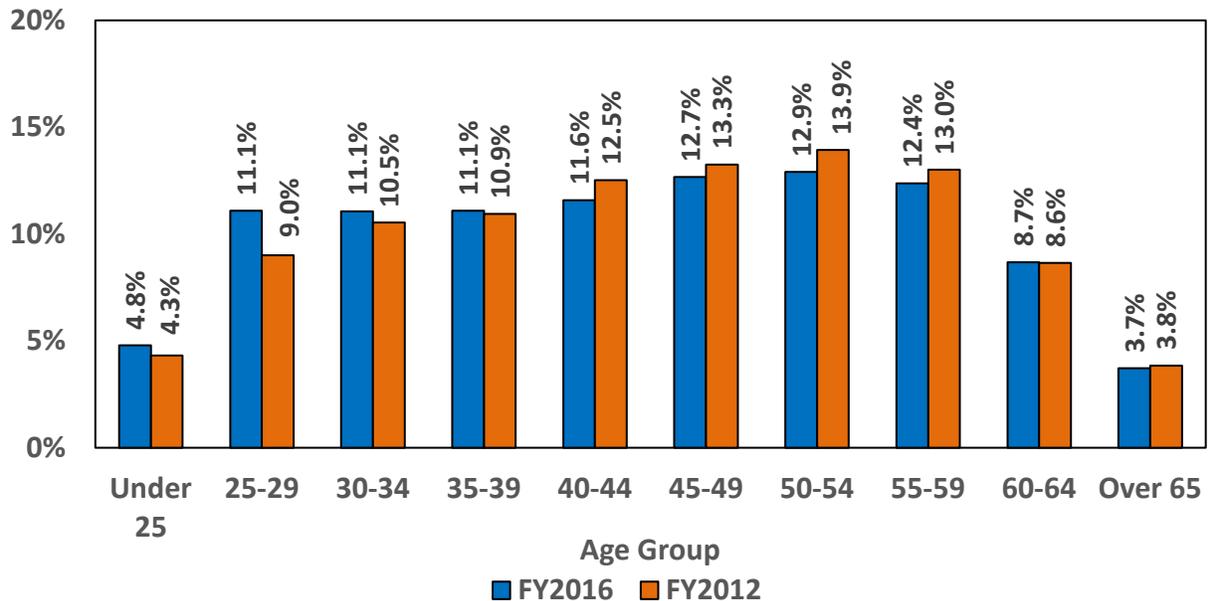


¹⁴ Figure B – State Personnel System Employee Headcount. Fiscal Year 2008 – 2016. State of Arizona Workforce Report. 2016. Although the State Personnel System was not established until FY 2014, headcount numbers in the chart for prior fiscal years reflect the same agencies that are now include in the State Personnel System to provide consist analysis over time.

Average Age of the Workforce

In FY 2016 the average age of a State employee was 45.5 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 10% while the age groups over 60 remained virtually unchanged. These charts suggest that the State will need to maintain market competitiveness at all levels of positions and work experience in order to continue attracting candidates from all age spectrums.

Figure 5
Age Distribution – FY 2012 and FY 2016¹⁵



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:

- Eight agencies are projected to have at least 20% of their workforce meet criteria for retirement in the current fiscal year
- Twenty-four agencies are projected to have at least 25% of their workforce meet criteria for retirement within the next five years
- There are thirteen 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 23% 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 2012 and 2016. State of Arizona Workforce Report. 2016.

¹⁶ Table 3.9 – Employees Meeting Retirement Criteria. Fiscal Year 2017 – 2021. State of Arizona Workforce Report. 2016. 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.

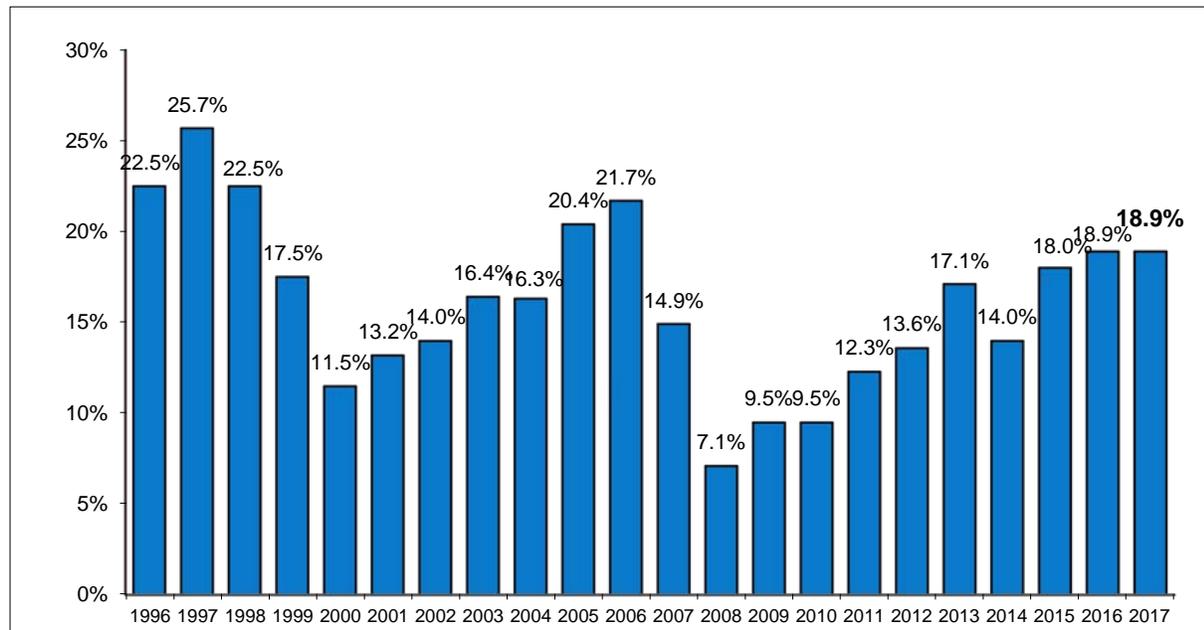
Figure 6
Actual and Projected Base Salary Increases¹⁷

Reference	2015 Actual	2016 Actual	2017 Projected
National - Korn Ferry Hay Group	3.0%	3.0%	3.0%
National - WorldatWork	3.0%	3.0%	3.0%
Economic Research Institute	2.9%	3.0%	3.0%
Local (Private Sector Only) AZ Compensation Survey	2.8%	2.6%	2.5%
Local (Public & Private) AZ Compensation Survey	2.3%	2.2%	2.2%
Local (Public Sector Only) AZ Compensation Survey	1.6%	1.3%	1.6%
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 18.9%.

Figure 7
Percent Needed to Get to Market¹⁸



¹⁷ National data from Korn Ferry Hay, Economic Research Institute, and WorldatWork websites; Arizona data from 2016 Arizona Compensation Survey.

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).

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.

Recent and Future Changes to State Government Workforce

Flexibility with Compensation

The current administration has provided agency leadership with increased flexibility in using compensation strategies to manage the workforce within their agencies. For example, past practice has been to limit the salary increase available to an internal promotional candidate to 7% of the midpoint of their new grade. While this may have served as a useful guideline, when external candidates applied to the same position, agencies were able to offer salaries using the full extent of the salary range with appropriate documentation. In effect, the practice resulted in more salary constraints for an internal candidate than an external applicant. Agency directors have been charged with running their respective organizations like a business, using the best management tools and strategies to ensure an efficient, effective government. This principle has been described as “freedom within fences” and the increased ability to provide salary increases for top performing employees is another example of this increased freedom.

It will be critical in the future for agency leadership to work closely with their budget officer and chief human resources officer. Ensuring this critical triad works well together will be necessary to make the best use of the compensation flexibility provided to agency leaders.

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. In FY 2015 additional classification families were reviewed and revised as market pressures dictated more competitive salary ranges and the development of appropriate career paths with a job family. Future classification changes are expected to result in a consolidation of classifications, delineation of career paths where appropriate, and market based salary ranges.

Strategic Workforce Planning

Most agencies are well versed in strategic planning, however, elevating this planning to another level of maturity will be necessary in the future. Agencies will need to become well versed in Strategic Workforce Planning, involving the identification of critical, pivotal roles in the agency and objectively assessing the human resource needs in those roles to be successful in the future. Additional resources and materials are being developed to aid agencies in this area.

Conclusion

The three considerations listed above, agency flexibility with compensation, overhauling the classification system, and strategic workforce planning are necessary and interrelated aspects of a new management system. It is well recognized that resources are limited, both human resources and fiscal resources. In order for agencies to be the most effective and efficient, agency leadership will need to be strategic and focused.

In the past several years, this Advisory Recommendation has identified classifications and job families that were significantly behind the job market as the primary justification for requesting additional funding from the Legislature. However, this strategy minimizes agency flexibility and assumes that all agencies have the same strategic goals and needs. For example, one agency may recognize their accounting positions as a strategic leverage point and may be willing to pay market rates, or even slightly above market rates to ensure the most talented employees are hired and retained. Another agency may recognize the importance of accountants, but may wish to focus their strategic efforts on a different family, such as engineers.

In the future, with the overhaul of the classification system, and a realignment of grades and salary ranges that are reflective of market conditions, agency leadership will have the tools and information to strategically target their limited resources in the areas and functions that provide the highest return for their investment.

Recommendation

Given the challenges of the State's current budget situation and considering the recent and future changes to the management system of the State, the Department recommends deferring any legislative salary increases at this time.

