State of Colorado

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Honorable John Hickenlooper
Governor of Colorado
136 State Capitol Building
Denver, Colorado 80203

Honorable Representative Cheri Gerou
Chair, Joint Budget Committee
Colorado General Assembly
200 East 14th Avenue
Denver, Colorado 80203

Dear Governor Hickenlooper and Representative Gerou,

In accordance with Section 24-50-104 (4), C.R.S., the State Personnel Director is required to submit an Annual Compensation Report and a letter of recommendation for annual adjustments to state employee compensation and benefits.

SUMMARY OF PREVAILING ANNUAL COMPENSATION AND BENEFITS COSTS

The State of Colorado has not funded annual salary increases for four consecutive years (Fiscal Year (FY) 2009-10, FY 2010-11, FY 2011-12 and FY 2012-13). The March 2012 Consumer Price Index for all Urban Consumers (CPI-U) annual percent change, as reported by the U.S. Department of Labor, Bureau of Labor Statistics, is 3.4 percent for the Denver-Boulder-Greeley area (CPI-U is not calculated statewide) and 2.3 percent nationally. Over the course of the past four years, the CPI-U has increased 8.9 percent cumulatively (3.9 for 2008, -0.6 for 2009, 1.9 for 2010 and 3.7 for 2011).

The Department of Personnel & Administration (the Department) reported the State was under the prevailing market for salaries by 3.9 percent overall in the FY 2011-12 Annual Compensation Report and by 5.2 percent overall in the FY 2012-13 Annual Compensation Report. In this year's FY 2013-14

> The U.S. Department of Labor, Bureau of Labor Statistics, publishes a Consumer Price Index (CPI) that provides a readily available metric that is close to a true cost of living measure. A cost of living metric measures changes over time in the amount consumers need to earn to reach a certain level or standard of living.

Annual Compensation Report, the Department's findings indicate the State is under market salaries by 9.2 percent overall. Specifically, 93 of 176 classes benchmarked against market are under market by more than the State's 7.5 percent target threshold. This represents 45 percent or 14,547 classified (appropriated and non-appropriated) employees. Another 42 of those benchmark classes are under market by more than 20 percent, representing 21 percent or 6,934 classified employees. Conversely, 23 benchmark classes are over market by more than 7.5 percent. This represents 8 percent or 2,667 classified employees. And 6 benchmark classes are over market by more than 20 percent, representing 1 percent or 448 classified employees.

The annual compensation survey findings on group benefits indicate that the State's share of contributions toward medical benefit plan premiums and the core benefit coverage are comparable with the market. They are slightly below the market for dental. As health care costs are projected to increase 10 percent for medical and 5 percent for dental based upon industry standards and the State's actuary's analysis, additional funding is necessary to maintain (for medical) and to reach (for dental) the prevailing levels.

The findings of the annual compensation survey related to salaries and benefits indicate that state salaries and group benefits are below prevailing market salaries:

- State employee salaries in aggregate are **9.2** percent below the overall market median salaries;
- State Patrol Trooper salaries are **30.3** percent below 99 percent of average market salaries; and
- Costs for health care are projected to increase by **10.0** percent for medical and **5.0** percent for dental.

The following table summarizes the overall estimated costs to reach prevailing market compensation and state contributions to group benefits:

FY 2013-14 Estimated Incremental Cost for Total Compensation Findings and Recommendations[1]

Type of Compensation	**Incremental Cost to Reach Prevailing Market Compensation**	**Incremental Cost Recommendation**
Salary Adjustments	$103,699,509	To Be Determined
Health, Life, and Dental	$18,425,309	$18,425,309
Total Incremental Cost	$122,124,818	To Be Determined

[1] The estimated incremental cost is for filled JBC appropriated positions which excludes non-appropriated positions in the Department of Human Services, Department of Transportation, and Institutions of Higher Education.

PAY STRUCTURE REDESIGN

Due to the significant overall differences between many state job classes and comparable market jobs, the Department conducted a major multi-year, comprehensive analysis of all pay structures in the State Personnel System. In addition to this large internal study, the Department contracted with the Hay Group for consulting services. The Hay Group is a global consulting firm with extensive experience working with state governments. The Hay Group confirmed the Department's methodology and direction related to a redesign of pay structures. Specifically, the Hay Group supports the consolidation of classes and utilizing separate pay structures for different groups of jobs, commonly referred to as occupational groups.

The State Personnel System transitioned to open pay ranges in 1998. Since then, few changes have been made to the State's pay structures. Across the board adjustments by occupational groups, minimal refinements to the pay structures, and salary and pay structure adjustment freezes for the last four years have caused the State's pay structures to fall out of alignment with the market. Three years ago, changes to the annual compensation survey resulted in an improved means for measuring the prevailing market by providing a direct comparison of the State's actual salaries and salary range midpoints to market actual salaries and midpoints. As a result, the Department has identified individual classes below or above the target threshold established for market comparisons, in some cases by more than 30 percent. Because misaligned pay structures have caused pay levels for some classes to fall out of a competitive position with the market, the Department has identified the need to correct or update the current pay structures.

It is not uncommon for individual job classes to become misaligned with market over time. This can result from an organization providing across-the-board pay structure adjustments based on average findings for an entire occupational group or job family, as the State has done. While there are common market trends in how salaries and structures adjust for jobs assigned to an occupational group, eventually, applying average increases across many classes may result in over-adjusting some jobs and under-adjusting others.

The Department communicated its plan to redesign all State Personnel System pay structures in the FY 2011-12 and FY 2012-13 Annual Compensation Reports and the State Personnel Director's corresponding recommendation letters. The FY 2013-14 Annual Compensation Report establishes new pay ranges for all State Personnel System classes and contains the Department's detailed plan for redesigning the pay structures. Details are contained in Appendix C of the Annual Compensation Report.

Implementing pay structure redesign is crucial, because it re-establishes the appropriate alignment of the State's pay ranges with the market, which is the framework for determining and maintaining competitive base pay levels through merit pay. As a result of the proposed pay structure redesign, the total number of pay grades in the State's compensation plan was reduced from approximately 384 to 109; with increases and decreases in both midpoint and range width. There are currently 500 classes that would be impacted by the pay structure redesign. Range midpoints of 244 (47 percent) classes would be adjusted up with increases ranging from 0.1 to 32 percent. Midpoints for 256 (50 percent) classes would be decreased from 0.1 to 28 percent.

Midpoints for all six of the trooper classes would increase by approximately 8 to 32 percent to reach in the statutorily defined market for trooper classes. One primary outcome of redesigning the pay structures is that some individual employee salaries will fall outside of the new pay range minimums and maximums.

For salaries that fall *below* new pay range minimums, there will be immediate costs because salaries will need to be adjusted to the new minimum on implementation. The Director's Rules require that no employee shall be paid lower than the range minimum (except in disciplinary actions resulting in salary temporarily below the range minimum). The Department estimates that up to 6,811 classified employees (appropriated and non-appropriated positions) will need to receive market pay in order to have base salary adjusted to a new range minimum as a result of pay structure redesign.

For employee salaries that *exceed* new range maximums, there may be no immediate cost avoidance, as Colorado statute mandates that salaries will be placed in "saved pay" status for a period not to exceed three years (24-50-104 (1)(e) C.R.S.). Saved pay provides a temporary means for maintaining base salary above the maximum of the pay range. The Department estimates that up to 2,026 classified employees (appropriated and non-appropriated) will be in saved pay as they will have a base salary above the new range maximum as a result of pay structure redesign.

This year's Annual Compensation Report also included one system maintenance study: The Information Technology Services and Applications Programmer class series. In accordance with the Director's Rules, system maintenance studies are implemented on a "dollar-for-dollar" basis where an employee's current salary remains unchanged when a class is moved to a new grade. An exception is when a class moves upward and individual employee salaries that are below the new grade minimum are adjusted upward to the new grade minimum via market pay. These costs are included in the salary adjustments costs above. A more detailed summary of the study findings is included in Appendix E of the Annual Compensation Report.

MERIT PAY AND PRIORITY GROUPS

All businesses – private and public – operate on the basis of employing individuals with a broad range of experience and skills, which translate to a total workforce well-placed across quartiles of pay ranges and allows for professional growth. Therefore, beginning in FY 2013-14, the State is moving toward a merit-based approach, as authorized by House Bill 12-1321. This approach will provide an annual compensation system designed to recognize performance and placement within the pay range. This affords lower paid, yet high-performing employees greater opportunity to work toward the midpoint of the range. Merit pay does not replace salary survey (cost of living increase). Merit pay may be a base and/or non-base increase. It is based upon placement in market, placement in range and performance.

Awards of merit pay will be based upon priority groups. The priority group for merit pay increases will be for employees based upon their performance and placement within the pay range as follows (A being the highest level of funding, F being the lowest level of funding and G being no funding):

Second Priority Group for Merit Pay Increases				
	Quartile			
Performance Level	**1**	**2**	**3**	**>=4**
L3	A	C	D	E
L2	B	D	E	F
L1	G	G	G	G

STATE CONTRIBUTIONS FOR GROUP BENEFIT PLANS

Overall findings of plan design and cost-sharing features indicate the State generally provides medical and dental plan options with common and prevailing coverage. For medical, the State achieved the prevailing employer contribution levels in FY 2012-13. However, with a projected 10 percent increase in medical costs, the State's contribution will need to increase in order to maintain a prevailing contribution level. For dental, the State's contribution is below prevailing market. In addition, a 5 percent increase is projected for dental care. Additional funding is necessary to achieve prevailing levels for dental contributions.

The following table compares the prevailing contribution levels within the market for FY2013-14 to the State's current contributions for FY 2012-13, by tier. The market comparison value in the first section represents 100 percent of employer contributions in the market or current prevailing market contributions.

Projected Medical Plan Premium Contributions for FY 2013-14 Determined at Prevailing Market Level				
Based on % Share of Contribution by Tier	**Employee**	**Employee +Spouse**	**Employee +Children**	**Employee +Family**
Prevailing Market Contribution for FY 2013-14 [1]	$470.20	$810.76	$726.48	$1032.98
Current FY 2012-13 State Contribution	$404.72	$733.24	$705.20	$1025.72
Difference	$65.48	$77.52	$21.28	$7.26

Projected Dental Plan Premium Contributions for FY 2013-14 Determined at Prevailing Market Level				
Based on % Share of Contribution by Tier	**Employee**	**Employee +Spouse**	**Employee +Children**	**Employee +Family**
Contribution Based on Market Share of Premium for FY 2013-14 [1]	$25.92	$42.62	$46.44	$62.22
Current FY 2012-13 State Contribution	$23.74	$38.30	$39.34	$51.18
Difference	$2.18	$4.32	$7.10	$11.04
[1] An adjustment to contribution ratio by each tier to reflect market tier ratios.				

Despite the fact that Colorado is one of the healthiest states in the U.S., the State has seen a high rise and prevalence of chronic disease, increase in obesity, increased prevalence of diabetes, greater incidence of disability and rise in the cost of medical expenses, and other disease-related costs. This, combined with the aging State employee population, presents a substantial opportunity to improve the health and well-being of our employees via a high-performing wellness program.

As a result, the Department is investigating a statewide wellness program designed to result in a long-term return on investment. These savings will come in the form of lower medical utilization and costs; lower disability and workers' compensation claims and costs; higher employee productivity, engagement and morale; lower absenteeism; and reduced employee turnover. Ultimately, this will result in a healthy, more engaged and higher performing workforce. Specifically, the program would increase preventive screenings and on-line health assessments to identify risk factors and to introduce interventions to improve employee health outcomes. This program would be available to all employees, regardless of their participation in one of the State's medical or dental plans.

TOTAL COMPENSATION ANALYSIS

The Annual Compensation Report has historically focused on the statutorily required elements of employee salaries and state contributions for group benefit plans; reporting results on these elements independently. Although the Department annually monitors market practices of other elements of total compensation, such as leave, retirement benefits and premium pay practices, these elements have only been reported when significant deviation from market findings exists or when special topics or areas of interest are identified. However, the Department recognizes the value of providing an overall measure of total compensation or remuneration in order to assess the overall competitiveness of the State's total compensation package.

As such, the Department has performed a comparison of the State's contribution toward retirement benefits to the employer contribution to retirement in the market. This analysis shows that the State contributes approximately 15.20 percent toward retirement benefits and the Colorado market contributes 12.10 percent. Additionally, the Department evaluated other group benefits offered by the State and found the coverage for short-term disability is commensurate with prevailing coverage in the market. However, life insurance and accidental death and dismemberment, as well as long-term disability are below prevailing levels. The Department will continue to work toward implementing a comprehensive measure of total compensation in future years.

The costs identified in this year's Annual Compensation Report and this letter indicate adjustments are needed for both salary increases and benefit adjustments to meet prevailing levels. The Department will continue to work closely with the Governor's Office of State Planning and Budgeting to develop a recommendation for the appropriate amount of funding for annual salary increases for FY 2013-14. Consistent with market practices and statutory direction, this recommendation will contemplate funding for salary survey (cost of living adjustments), base and non-base merit pay components and market pay (movement to range minimums). Furthermore, this recommendation must consider the results of the annual compensation survey, fiscal constraints, and the ability to recruit and retain state employees. Also, the recommendation letter must outline the reasons for any deviation from prevailing total compensation. The recommendation will be submitted with the Governor's November 1 Budget Request.

Respectfully submitted,

Kathy Nesbitt
Executive Director

cc: Colorado General Assembly, Cabinet Members and Higher Education Presidents