Total Compensation

Moving Toward A Flexible, Integrated Total Compensation Program

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Total Compensation Strategy:
Moving Toward a Flexible, Integrated Total Compensation Program

What is Total Compensation?

Total compensation is an employer's human capital investment strategy that considers all aspects of rewards (compensation) in creating a competitive package for the workforce, thereby improving business outcomes. Components include:

- Fixed pay – Base salary;
- Variable pay – Performance pay, incentive pay, discretionary pay, or premiums;
- Group Insurances (health, dental, life, AD&D, disability);
- Leave;
- Retirement;
- Employee Training/Education; and,
- Work-life Program.

State of Colorado Statutory Compensation Philosophy

"It is the policy of the state to provide prevailing total compensation to officers and employees in the state personnel system to ensure the recruitment, motivation, and retention of a qualified and competent work for…." [24-50-104 (1)(a)(I) C.R.S.].

Introduction

The State has been moving toward a flexible total compensation program as part of a streamlined, modern, and efficient human resources system, one that can better respond to the market and meet the needs of a changing workforce. Total compensation is one facet of comprehensive reform that started over a decade ago. The Department has successfully implemented other initiatives to move the State in this direction. These initiatives have included redesigning the State's job evaluation system, creating open salary ranges, implementing performance-based pay, consolidating and reducing State job classes, providing pay premiums, and developing a comprehensive work-life program.

The total compensation pay philosophy has been in law for a number of years and was originally envisioned as a more comprehensive approach. However, it has not been fully implemented due to past contradictions in laws, and fragmented funding and decision-making processes. With very few exceptions, the General Assembly has historically and consistently funded market salary adjustments at prevailing levels based on the salary survey process. The State's contributions to group benefit plans, however, were actual dollar amounts specified in statute and required a proactive legislative action to change. This led to some unintended consequences where, over time, the State's contributions to group benefit plans significantly lagged the market.

During the early 1990s, when pricing in the health insurance market remained relatively stable, less emphasis on the State's contribution to group benefit plans had only a minor impact on total compensation. However, recent years of double-digit premium increases in the health insurance market and limited funding to the employer contribution to group benefit plans have become detrimental to the State's competitive position, particularly for lower and middle-income employees. This makes it increasingly difficult to recruit new employees and retain newly hired employees. It also leaves the State inadequately prepared for the large number of impending retirements due to our aging workforce.

In 1989, the Legislative Audit Committee recommended a total compensation approach to achieve the best value for the workforce. Through the years, a number of private auditors have independently suggested that the State evaluate total compensation funding as one cohesive appropriation, instead of elements of a program that require unrelated budgetary allocation processes.

The Total Compensation Reform Act of 2003 (HB03-1316) significantly improved the statutory framework for implementing the State's total compensation philosophy. The implemented FY 2004-05 total compensation recommendation increases the State's contribution to group benefits plans from an average of 49 percent to 56 percent of the market beginning January 1, 2005, and approximately 75 percent on July, 1, 2006, meaning that if the market showed comparable employers contributed $100 dollars toward total premium, the State contributed $49, then $56, followed by $66 on July 1, 2005, and will now contribute $75.

Another critical change is the move away from the State's historical anniversary (step) increases to performance-based awards. This shift is paramount for accountability to the taxpayers because it represents the State's expectation that its employees earn salary increases based on their performance. Meaningful performance-based awards must become the primary way that employees earn upward movement within their salary ranges. This relies upon consistent and adequate funding for performance-based pay.

Strategic Vision

The State's total compensation philosophy and its strategic vision are built upon the following premises:

1. Create the governance for successful implementation;
2. Close the funding gap in benefits;
3. Maintain market-competitive salary ranges;
4. Make performance awards meaningful with consistent and adequate funding, and use them as the way for employees to move upward within their salary ranges; and,
5. Further down the road, create a more flexible total compensation package, in which individual employees can tailor total compensation packages to meet their individual values and needs.

This vision of a flexible total compensation package allows the State to meet the needs of a diversified workforce of around 31,500 employees (36,000 for benefits). The State's strategic vision lays the groundwork to implement a comprehensive and integrated approach to total compensation in the next three years that will further maximize the State's investment in its workforce.

Creating the Governance

The State's performance pay system and Total Compensation Reform Act have created two new and critical statutory steps to facilitate the implementation of the total compensation strategic vision. This foundation, however, can be improved. While statute conjoins the three primary components of total compensation requiring new funds, it still treats funding of these components as separate pots. One appropriation for all components of total compensation would create greater flexibility and bring the State closer to a flexible total compensation program. Based on Legislative support and professional staff recommendations, the Director could allocate the best mix for the workforce, helping the State maximize its investment in its workforce.

The State has effective statutes, rules and procedures, and policies that support employee training and education, variable pay practices, and work-life programs. However, current leave policy, which puts different kinds of leave in different categories, runs counter to the strategic vision. All forms of paid time off basically represent compensation. It is important to look at leave reform to better align leave policies with other components of total compensation.

The State needs to prepare for the impending loss of the baby boomers and position itself to be an employer of choice for new generations of workers. It must create ways for the changing needs of its employees to be accommodated through flexible compensation choices – empowering employees to make decisions about their compensation. Offering new employees alternative, and more portable, retirement options (as the General Assembly did in 2004 by passing SB04-257) align with an integrated total compensation strategy that empowers employees and creates greater flexibility.

Closing the Gap in Group Benefit Plans

The State's group benefits plans lag the market in both employer contribution and plan design features, such as co-pays, co-insurance, and out-of-pocket maximums. This gap negatively impacts the State's ability to offer a competitive total compensation package, which as also identified in the *Performance Audit of the 2005 Annual Total Compensation Survey Report*. While both aspects of group benefit plans must be addressed, the Department's priority is to close the gap in employer contributions before adding the costs associated with richer plan designs so affordability is not adversely impacted.

When the FY 2006-07 recommendation is implemented, the State's gap in employer contributions to group benefit plans will be cut by close to a quarter. The Department's strategy is to close the gap gradually within five years beginning January 1, 2005. After that, the focus will be on maintaining competitive contribution levels, improving plan design features, and enhancing benefits. The State's demographics (e.g., average age of 47) and geography (all counties) drive higher overall medical costs compared to employers with which the State competes. Consequently, when the State achieves and maintains the prevailing market employer contributions to premium, the relatively higher costs for our risk pool may require still higher state contributions to also make plan designs and cost-related features (e.g., deductibles and out-of-pocket maximums) competitive in the labor market.

Examples of potential enhancements are two pieces of legislation passed in the 2004 session. The Director studied the feasibility of offering a High Deductible Health Plan (HDHP) that qualifies for a Health Savings Account (SB04-094). In fact, one of the group medical plans is a qualified High Deductible Health Plan with an option to enroll in a Health Savings Account, as part of a consumer-driven approach to health care. Legislation was also passed creating more options for retirement plans (SB04-257) that introduce portability, which may be attractive to newer or short-term employees. Another positive has been the passage of SB04-08, which eliminates the requirement of two HMO offerings for each county with over 500 state employees, and greatly enhances the State's ability to consolidate risk and negotiate for health coverage.

On July 1, 2005, the State moved its group insurance plans to a fiscal year cycle. This move better coordinates benefits with the other components of total compensation. Additionally, the Department conducted a comprehensive analysis on self-funding the State's group medical and dental plans. Not only is self-funding financially feasible without any additional fee to employees, it also provides much needed control and flexibility. This analysis showed that the risk is well worth the reward, and over time the State will be able to provide better choices and better control premiums.

Maintaining Competitive Salary Ranges

The Department will continue to use professionally sound and valid methodologies to analyze the job evaluation system and survey the market to adjust salary ranges. The job evaluation system is the foundation for determining salaries. Over the past 12 years the Department has eliminated obsolete job classes, consolidated similar classes, and made the system more flexible. The Department will ensure that State jobs, classes, salary ranges, and occupational groups match the market and serve our business needs. Maintaining competitive salary ranges, and making sure employees are paid within those ranges, preserves the structural integrity of the State's base pay system and helps ensure competitive pay.

Providing Meaningful Performance Awards as the Way for an Employee to Move Upward Within a Salary Range
Under the State's former anniversary (step) system, there was no means to differentiate performance and reward accordingly. Employees simply had to be employed on their anniversary dates to receive an automatic salary increase. If nothing else, accountability to the public made this practice unacceptable. The former system, while not ideal, did provide a clear and predictable way for employees to move upward within a salary range. Since the State abolished anniversary increases and implemented its performance pay system, funding levels for performance awards have not met the historical 2.2 percent of payroll in place at the point of transition as originally intended. This lack of funding has created a situation where successful employees are now falling back or remaining in the same position within their salary ranges. Assuming the State continues the current path to closing the gap in contributions and plan design features to group benefit plans focus must shift into meaningful performance awards, which is the way to move successful employees upward within their salary ranges. It is critical that the State takes the crucial financial action necessary to restore funding as soon as possible to this fundamental element of the compensation system.

Moving Toward Flexible Total Compensation
The Department's strategy is building toward the basic principle of an integrated total compensation program. That is, recognizing the employee, not the employer, knows the best mix of all total compensation elements including salary, benefits, paid time-off, retirement, etc., that meets his or her needs and values. While the employer sets the basic parameters and controls funding levels, the employee helps create a total compensation package that best meets his or her particular needs and values. The Department will continue to design programs that pursue equity for the workforce as a whole while empowering greater individual choice.

Conclusion
In order to meet the expectations of those entering the workforce and to retain top performing employees, it is imperative for the State to continue down the total compensation path. Benefits are no longer a "fringe" component of a total compensation package, and must be competitive. Comparable employers provide incentives, bonuses, and sophisticated work-life options. A work-life program helps create a high-performing work environment by using flexibility to maximize efficiency and productivity. The State, too, must continue its commitment in these areas in order to create a system responsive to rapidly changing market conditions. The base pay structure must remain market-competitive as the sound basis of the State's pay program and support for the strategic vision. All pay practices need to be continuously evaluated and modified, if needed, in order to support the Department's strategic vision. Paid time off needs to become less fragmented and be integrated as part of the total compensation program. Performance should be the foundation for all salary advancement in the system, and the mechanism for moving employees upwards within

salary ranges. Lastly, the Department should continue to create more flexible governance, one that can balance the needs of individuals and the entire workforce.

Tentative Six-Step Timeline

The following tentative timeline provides the broad framework for meeting the State's compensation philosophy, implementing the Department's total compensation strategy, and moving toward a flexible compensation philosophy.

Step 1 - complete

- Change procedures to create more statewide consistency in and fine tune the performance management system – *completed* spring 2004;
- Push to eliminate two-HMO requirement in order to help improve the State's purchasing power for health coverage – *passed* spring 2004:
- Comprehensive analysis on the return to self-funding – *completed* spring 2004;
- Align salary ranges to move with the market and leave no employee below range minimum – *implemented* 7/1/04;
- Implement performance awards funded at 1.1 percent of payroll – *implemented* 7/1/04; and,
- Assist with the implementation of SB04-257, which will provide employees greater flexibility in retirement choices – *passed* spring 2004.

Step 2 – complete

- Analyze the State's workforce training and education programs as a foundation to development of a new integrated training strategy – *completed* spring 2005;
- Continue to move salary ranges with the market and have no employee below range minimum – *implemented* 7/1/05;
- Examine integrated incentive program – *report delivered* to the General Assembly 12/1/04;
- Recommend performance awards at 1.1 percent of payroll – *completed* 8/1/04 but not funded;
- Move group benefits plan year to a fiscal year cycle to align with other total compensation components – reported in the Annual Compensation Report 8/1/04 and *implemented* 7/1/05;
- Implement self-funded group medical and dental plans if practical and competitive with market rates – *completed* 7/1/05;
- Offer an HSA-eligible high deductible health plan – *implemented* 7/1/05; and,
- Increase State contribution to group benefits plans from 49 percent to 56 percent of the market – *implemented* 7/1/04.

Step 3 - complete

- Develop ongoing broker-model plans for statewide training and education – *implemented* 7/1/05;
- Implement alternative retirement options – *implemented* 1/1/06;

- Continue to move salary ranges with the market and have no employee below range minimum – *implemented* 7/1/06;
- Recommend building performance awards to a more meaningful percentage of payroll – *completed* 8/1/05 but not funded;
- Explore Health Retirement Accounts – *report delivered* to the General Assembly 12/1/04; and,
- Recommend an increase to employer contribution to group benefit plans that goes to 60.5 percent of the market beginning July 1, 2005 to coincide with move to fiscal year benefits cycle – *implemented* 7/1/05 at 66 percent.

Step 4

- Recommend an increase to employer contribution to group benefit plans that goes to 75 percent of the market beginning July 1, 2006 – *implemented* 7/1/06;
- Support legislation to implement the Legislative Audit Committee's recommendation to create a single appropriation for salaries – *HB06-1047 failed* but still pursuing;
- Begin assessing appropriate total value measurements of a comprehensive total compensation package, beginning with a measure to value assess benefits costs – *implemented* 7/1/06 reduced self-funded medical out-of-pocket maximums (approximately 50%) and increased self-funded dental maximum benefits (approximately 15%-16%) as initial steps in addressing self-funded plan design features;
- Develop integrated incentive program;
- Analyze options for leave reform, including the need for any statutory change to make leave governance consistent for all types of leave;
- Continue to move salary ranges with the market and have no employee below range minimum; and,
- Recommend building performance awards to a more meaningful percentage of total payroll.

Step 5

- Attain State contribution levels to group benefit plans at 85 percent of the market;
- Implement an integrated training strategy;
- Develop a method to determine employee value of the types of group benefit plans offered;
- Continue to pursue competitive plan design features as funding permits;
- Implement leave reform;
- Implement integrated incentive program;
- Attain performance awards at a level that will adequately provide a way for employee upward movement within a salary range; and,
- Continue to move salary ranges with the market and have no employee below range minimum.

Step 6

- Attain State contribution levels to group benefit plans at 100 percent of the market;
- Obtain funding to pursue competitive plan design features;
- Continue to pursue competitive group benefit plans through innovative plans and approaches that create value and are cost effective for the State and employee;
- Implement appropriate total value measurements of a comprehensive total compensation package;
- Explore options for allowing individual employee tailoring of a total compensation package;
- Continue to move salary ranges with the market and have no employee below range minimum; and,
- Continue to recommend performance awards at a level that will provide a way for employee upward movement within a salary range.

Step 7

- Continue to pursue competitive group benefit plans and funding by maintaining prevailing employer contributions to premium, improving plan design features, and adopting innovative plans and approaches that create value and are cost effective for the State and employees given the State's unique demographics; and,
- Introduce options for allowing individual employee tailoring of a total compensation package.