

Budget and Fiscal Affairs Advisory Committee

Review of

Watson Wyatt Report on

Pay for Performance, Position Classification and Compensation

Benefits and Compensation Philosophy

October, 2009

I. City's Adoption of Strategic Plan and MFRI Principles and Implementation.

In keeping with its Strategic Plan and Goals, in 2006 the City initiated its Managing for Results Initiative (MFRI) to improve the functioning of government planning, budgeting and program implementation in order to improve results and increase efficiencies. MFRI development and adoption was a logical implementation step flowing from the initial framework of the Strategic Plan.

Many of these actions put in place BFAAC recommendations and the Committee has applauded these steps over the last few years. In its FY 2010 report, the Committee recommended a continued review of the factors used in MFRI, an analysis of the experience to date to continue and improve the process, and that the City move toward a pay-for-performance salary program.

The City contracted last year with Watson Wyatt (WW) to analyze and make recommendations concerning the City's employee position classification system, its employee compensation and benefits package, and its compensation philosophy. WW has completed its evaluation, which included comparisons of the critical items to not only surrounding jurisdictions but also other jurisdictions in the State of Virginia, and has tendered its recommendations.

Earlier this year, City Council, upon receipt of preliminary WW reports, asked BFAAC to review the report and make any appropriate comments prior to Council consideration of the full report in the upcoming budget cycle.

II. Watson Wyatt Comments and Recommendations:

How we compensate our employees, both active and retired, is tremendously important. All forms of compensation, including pay and benefits have been analyzed in this study, and BFAAC will comment on all areas. However important all forms of

compensation are, clearly the lion's share of the analysis, and work to be done, lies in the area of pay, i.e., job classification and salary compensation.

BFAAC will also comment on benefits, both collectively and individually. As BFAAC previously stated, the benefits portion of compensation has not been in keeping with the stated philosophy for some time. In addition, the cost of benefits has become a much more uncontrollable form of compensation over many years, and the City must address this issue. BFAAC has recommended that the City consider total compensation when studying the marketability of City jobs to that of surrounding jurisdictions. As such, it is important to address, and comment on the benefits analyzed in the WW study.

Compensation

Job Classification System: WW recommends that the City embark on the development and implementation of a new City employee job classification system. Moving from the current system towards a "whole-job" classification system will be beneficial in fully utilizing the philosophy of MFRI, specifically bringing transparency and flexibility to the process. WW is recommending that the needs of the City would be best met by developing a competency approach, a variation of the whole-job evaluation in which jobs are compared to descriptions of competencies.

The City already has taken several actions related to this recommendation, starting with a contract with WW to develop a new classification system. Therefore, WW has developed, distributed and collected job analysis surveys from nearly 3000 employees. WW and the City's HR Department are working with a committee of 20 employees on feedback and are reviewing roles, levels and competencies for each of the job levels. The City review of this framework of a competency-based classification system has gone to Senior Staff and will go in a meeting on October 22nd to the Council Subcommittee on Pension and Compensation for review of compensation issues and also to provide an overview of the new classification system.

Benchmarking: With regard to the current benchmarking practice, WW recommends increasing the number of benchmarks, reviewing the class specifications for accuracy and updating them as necessary, increasing the number of benchmark positions, reviewing the definition of competitive position against market, addressing non-benchmark jobs through the chosen job evaluation method, reviewing the process for applying market data to the pay scale, and increasing the number of published survey sources used in the benchmark process. WW recommends that the City first address jobs that have already been assessed through previous benchmarking, adjust where necessary, then revise all classification specifications where necessary; then use the updated material to then conduct the ongoing benchmarks. WW also recommends eliminating the automatic linking of non-benchmark jobs, and instead, slot each non-

benchmarking job using the benchmark jobs as a guide. WW recommends benchmarking occur at least every two years.

The City informs our subcommittee that recent benchmark data is available now for 63 job classes and their linked jobs. This information has been forwarded to the Senior Staff and will be presented to the Council Subcommittee on October 22nd and to the Council on November 7th. HR anticipates another benchmark survey to be conducted in the spring once the new system is in place. It appears that this means three sets of benchmarking, but it is not clear in which fiscal years these results may be utilized or actually implemented.

Pay Scale: WW recommends improving the competitiveness of the pay scale through the benchmarking process as an area of opportunity. This would address several concerns voiced by the focus groups, i.e. treatment at the top of the range, competitiveness at hiring, and the treatment at promotion. Ensuring that the ranges are aligned to comparators and adhering insofar as possible to a hiring policy that limits pay setting to the first quartile, and if funding is available, paying a lump sum (that does not increase the base pay) to an employee that is at the maximum of the range would address these issues. The City's salary ranges are designed to be competitive at the midpoint, but minimums and maximums also need to be competitive in order to attract and retain employees.

Promotions: WW feels that the installation of a new classification system and setting the ranges to a proper position can address the two major concerns about promotions, namely the hiring of an individual at a higher rate than internal employees, and the disincentive of applying for a supervisory job that pays less than those supervised.

Compensation Philosophy: The City's stated pay philosophy has been that, when compared with surrounding jurisdictions, which had been summarized as "neither a leader nor laggard be." WW believes that updating the compensation philosophy early in the process is necessary. This process is underway concurrent with the job classification activity mentioned in that section above and will be reviewed with the Council Subcommittee as well.

Pay-for-Performance: WW notes that the difference between public and private sector performance management practices is lessening. A 2003 GAO report states "leading public sector organizations use their performance management systems to accelerate change, achieve desired organizational results, and facilitate two-way communication throughout the year so that discussions about individual and organizational performance are integrated and ongoing. Effective performance management systems are not merely used for once or twice yearly individual expectation setting and ratings processes, but are tools to help the organization manage on a day-to-day basis."

WW recommends changing the performance evaluation form to include competencies. The new performance management system must be rigorous and integrated with the new classification system. Highly recommended is that managers, supervisors, and employees be included in communications and trained in the performance management process. Training should emphasize performance planning, coaching and feedback, and performance reviews.

Benefits

Benefits Comparison: The study shows that Alexandria ranks very well in relation to the comparator jurisdictions in regards to benefits for general employees. Benefits include Retirement, Health, Paid Time Off and Security through Life Insurance and Disability Insurance. Collectively it leads all the other jurisdictions, with general employees leading comparator jurisdictions in nearly all categories except paid time off and short term disability. This is not the case for ERT employees (averaging 3 and 4), Police (averaging 3 and 4), Fire (averaging 4 and 5), and Sheriff (averaging 3 and 4) However, the complexity of these comparisons should not be ignored if one chooses to merely look at the resulting comparison number. In some cases, the differences are secondary to the value of the individual benefit being measured, some being more valued than others. And, each employee may personally value these benefits differently.

The objective is to attract and retain talented employees as well as providing compensation that is fair to both the employee and to the City. With this in mind, a great deal of work may be necessary to review individual benefits, and indeed, component parts to that benefit to assess what actions may be necessary to maintain, or adjust that benefit.

The City has designed and distributed an employee benefits and incentive survey that will be completed and will ask for employee response by the end of October. The results will not be known for several weeks but will be forwarded to the City Manager, senior staff, BFAAC and ultimately to Council to be available as the budget cycle consideration for next fiscal year proceeds.

Retirement: Alexandria ranked overall very well in this category, chiefly because of the more generous ways in which the City offers its Defined Benefit (DB) program. WW indicates that enhancing the DB plan can be achieved by reviewing early retirement provisions plans for Sheriff, Police, and Fire to determine if they need to be more competitive with other jurisdictions, and to consider offering a match on the 457 employee savings plan.

WW notes that under a DB plan, these recommended enhancements will represent additional cost to the City and should be thoroughly evaluated before enacting. WW also notes that, in contrast, these costs of changes under a Defined Contribution (DC)

plan would have better predictability and less volatility for the City as investment risk is shifted from the City to the employee.

Health: WW does not recommend any changes to the City's medical benefits. Taken as a whole, the City's medical and prescription plan benefits are in line with comparator jurisdictions. The City's number 1 ranking in this area is chiefly driven by the relatively low percentage employee contribution towards the cost of medical benefits. If the City wishes to make adjustments to this benefit, it is this area that could receive the majority of attention. The City could also continue to address and promote health-related programs and activities, and assist employees to understand just where health care costs occur. Each employee is an investment. Good health maintenance is an investment in productivity.

The City's dental plan ranks at the bottom of the comparator jurisdictions. WW recommends that an employer contribution toward a basic dental plan could be made available, with the ability of the employee to buy up.

Paid -Time Off: The City ranks last in this benefit. However, the City must look at the actual difference between ranked first and last within an individual Paid Time Off category. Since the analysis, the City has added an additional paid day of annual leave, effective 7/1/2009. WW has no specific recommendations other than reviewing the sick leave and its relation to Long Term Disability.

Security (Life Insurance and Disability): The City ranks in the top three in this area of benefits. These require little or no cost to the City, and are perceived as valuable by employees. In addition to these benefits, WW recommends that the City may want to look at similar types of benefits, e.g., Long Term Care, which also will not cost the City much, and could be paid by the employee who would benefit in a lower cost due to a group buying process. WW also recommends that the City evaluate the current disability program, to ensure that it is providing adequate income protection in the gap between sick leave (8 days) and long term disability coverage (4 months). In addition, WW recommends that the City also consider offering Long Term Care insurance.

III. BFAAC Recommendations:

BFAAC has previously supported budget modernization including: strategic planning, instituting the Managing for Results Initiative (MFRI), and a re-examination of the salary and performance review process that has been in place for several years. BFAAC has recommended a new performance management system based in part on a pay-for-performance approach to employee evaluation and salary.

In reviewing the Report, we agree with the view of WW and many managers and employees that the current approach to compensation is outdated and needs to be changed. We believe that the approach it proposes is in keeping with the direction and

improvements in budgeting and management for results instituted in recent years and mentioned above.

In recent months, the City has begun the process of revising the approach to performance and compensation. Steps that are now underway, directed by the newly reorganized Human Resources Department and involving a broadly representative cross-section of management and various levels of employees, generally seem to be the right approach.

To aid in that endeavor, we offer these comments on what we believe are some key elements in performance management:

- The process itself and its implementation must be clearly understood and believed to be fair, so that managers and employees have trust in the system.
 - To build trust, employees must have knowledge of the system, how it works, and how it may affect individual employees, specific departments and/or job categories.
 - After a system is developed with significant employee involvement, training for managers and employees becomes a strong component to achieve the trust mentioned above.
 - A key component of maintaining a trusted system is for top management and HR to develop and apply a review system of performance evaluation, see that principles are consistently and fairly applied, and include ongoing review of performance evaluation decisions.
 - A check on fairness in the system may involve development of an appeal procedure.
- Terminology should be clear; some terms in the WW report do not seem to be the ones currently used in regular City parlance; management should be sure that everyone is “talking the same language,” with the same meaning applied.
 - There should be well understood definitions of standard terms such as: performance management system, pay-for-performance compensation, market rate adjustments, COLAs, benefits, benchmarking, salary compression, job descriptions vs. job categories across departments, etc.
 - Market rate adjustment: An example of a terminology problem is the City’s change two years ago from “cost of living adjustment” (COLA) to “market rate adjustment” (MRA) to describe increases at that time to salaries of all employees; the terms may seem synonymous, but they are not, relying on different baseline data. MRA actually is based on salaries or salary averages in comparator jurisdictions.

- The subcommittee believed that further clarification of the term “market rate adjustment” was needed. As used now the City has applied such an adjustment to all employees on the current schedule. With the changes now underway in the City system, the question arises as to whether in a performance management system, that the term and its current impact is compatible with a “pay-for-performance” approach. Must MRA apply to all employees as has been done in recent years, and in effect has an impact similar to a COLA, or should it be applied only to specific jobs or categories of jobs to make compensation for those jobs more competitive in the region or for equity within the City’s compensation system?

The committee asked for clarification from the HR Director and it appears that market rate adjustment and COLA are viewed similarly and when applied will be applied to all or nearly all City jobs and the employees who currently hold those positions.

Pay for performance: Further comment reveals an understandable emphasis by the City upon reclassification and setting up the performance management system. It is not clear how or when performance-based pay will be integrated into the new system. Our view is that pay for performance should be an essential element in the comprehensive performance management system now being rolled out and implemented as soon as feasible.

Other Recommendations:

The City’s total compensation package needs to be competitive with surrounding jurisdictions in order for the City to attract and retain the caliber of employees needed to provide productive excellence within the workplace. Therefore:

- Benchmarking to compare City salaries and benefits with surrounding jurisdictions should be ongoing to maximize competitive advantage. A gap of two years between benchmark reviews is probably too long from both a data collection perspective and the need for retraining of those involved.
- We agree with WW that revising the City’s current compensation philosophy is critical and needs to be addressed and instituted early in the process, preferably in concert with the development of the new compensation system.
- Once again BFAAC states, as it has in previous reports, the City should look at both salary and benefits combined in assessing its ability to attract and retain quality employees. The City’s compensation philosophy should also be rewritten or reformulated to guide actual practice. With major change in the approach to compensation of all types and formulation of a performance management system, this is the time for such a review. This “cost to the City” approach should also be utilized in appropriate budget analysis, and presented in a transparent form.

Focus should be on instituting the new performance management system, not on changing benefits.

- Management and HR staff time and emphasis of the message to all staff should be on reorganizing the performance management system and related compensation and performance measures, not on restructuring benefits.
 - Having stated the above premise, some change may be in order to improve linkages between sick leave and short- and long-term disability to make a smoother transition and to improve linkages for employees facing the need for such benefits.
 - The City may choose to explore development of a plan allowing employees' to purchase Long Term Care policies at more favorable rates through a City sponsored group.
- Absent in the WW report and this analysis is any mention of ACPS. Since the City is a major source of funding for the schools, addressing similar, but appropriate studies on a school performance management system including elements moving toward a pay-for-performance system should be recommended to ACPS and then undertaken by the School Board.

IV. Conclusion: The City's FY 2011 budget, based on strategic goals, needs to focus on identifying and quantifying the value created from the efficient and effective provision of City services. Implementation of many of the recommendations outlined in the WW report is underway, and moving in a positive direction in the view of our Committee. If properly implemented, these changes will significantly help the City in attaining that goal.

Council should provide ongoing monitoring of these significant changes. Council should be assured that they lead not only to an improved management system based on greater efficiency, effectiveness and increases in performance, but also builds trust of management and employees in each other. A system that is fair, properly applied and effective throughout the City workforce should be the achievement for which we all strive.