

Joint Legislative Audit and Review Commission



**Review of State Employee
Total Compensation**

House Appropriations Committee Retreat

November 19, 2008



JLARC

Study Mandate and Legislation

- On November 13, 2006, the Commission authorized JLARC staff to study compensation for employees of the Commonwealth
- 20 bills referred to JLARC study by House Appropriations Committee (2007)
- Other bills / issues referred by Members, House Appropriations Committee, and House Rules Committee (2007 and 2008)

In This Presentation

- Background
- Assessment of Total Compensation
- Assessment of Major Total Compensation Elements
- Summary of Potential Options
- Summary of Total Compensation Options for Further Consideration and Analysis

Primary Focus of Study Was Total Compensation for Classified State Employees

■ Total Compensation

- Salaries
- Health insurance
- Leave benefits
- Bonuses
- Retirement benefits

■ Classified State Employees

- Subject to Virginia Personnel Act
- 73,629 as of January 2008

Review Synthesizes Voluminous Research From Three Different Organizations

JLARC Staff

- Project design / mgmt
- Analysis of historical, current, & projected costs
- >100 interviews
- Agency & employee surveys
- Assessment & options

PRICEWATERHOUSECOOPERS

- Retirement trends & best practices
- Retirement plan comparison
- Retirement plan assessment / recommendations
- Estimated impact of potential options

MERCER MARSH MERCER KROLL GUY CARPENTER OLIVER WYMAN

- Total comp trends & best practices
- Total comp comparison
- Total comp assessment / recommendations
- Estimated impact of potential options

Review of State Employee Total Compensation

Salaries and Benefits Are Intended to Achieve Six Key Purposes

- Recruitment
- Retention
- Motivation & Morale
- Health & Productivity
- Retirement
- Work / Life Balance

In This Presentation

- Background
- **Assessment of Total Compensation**
- Assessment of Major Total Compensation Elements
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- Total Compensation Options



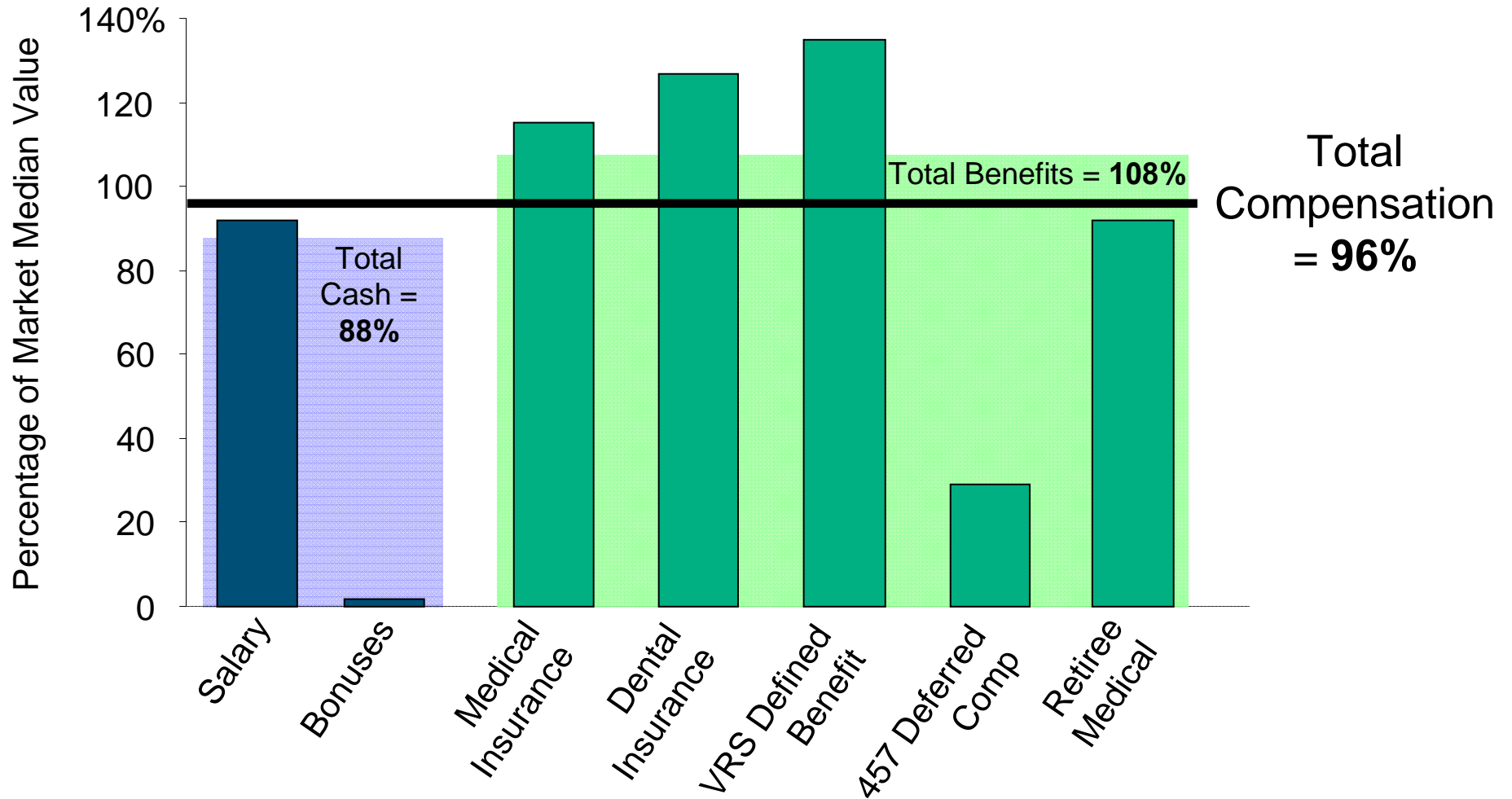
Most Agencies Report Total Compensation Achieves Recruiting and Retention Purposes

- Statewide turnover rate in 2007 = 11.5%
 - Similar to other governments
 - Lower than private sector
- 81% agreed their total compensation attracts qualified staff

DOC and DMHMRSAS Facilities Disagree

- 16 agencies with turnover above 20% were DOC or DMHMRSAS facilities
 - 13 in Northern Virginia, Tidewater, or Richmond area
- Less likely to agree their total compensation attracts qualified staff
 - 9 agencies strongly disagreed -- all DOC or DMHMRSAS facilities

Mercer Found Virginia's Total Compensation Generally Competitive



Competitiveness Varies Considerably by the 43 Job Roles Mercer Benchmarked

Range of Competitiveness (% of Market Median)	# of Job Roles in Range	% of Total Job Roles Benchmarked
<90%	7	16.3%
90% - 110%	23	53.5
>110%	13	30.2

- Job roles with above-average turnover tend to receive less competitive total compensation



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Salary Is Not State's Primary Recruiting and Retention Tool

- Only 9% of employees chose to work for and remain with the State because of salary
- Only 36% of employees agreed their salary was an attractive part of their compensation package
- Salary was most-cited reason why employees left their job in FY 2008

Mercer Found Virginia's Base Salaries Marginally Competitive

- Base salaries were, on average, 92% of the market median
- Total cash compensation was, on average, 88% of the market median
 - Lower value of bonuses provided by State

Competitiveness of Base Salaries Varies by the 43 Job Roles Mercer Benchmarked

Range of Competitiveness (% of Market Median)	# of Job Roles in Range	% of Total Job Roles Benchmarked
<90%	14	33%
90% - 110%	19	44
>110%	10	23

- Job roles with above-average turnover tend to receive less competitive base salaries



Motivation Negatively Impacted Due to Employee Dissatisfaction

- Nearly 11,000 employees report they are dissatisfied because of salary issues
 - Uncompetitive
 - Annual increases inadequate
 - Salary compression
 - Cannot afford basic living expenses

Finding

	<i>Purposes</i>			<i>Cost</i>	
	Recruit	Retain	Motivation & Morale	Current \$ (millions)	Future \$ Risk Level
Salary / Total Cash	◐	◐	◐	\$3,301	Low

Scale of Purposes Achieved ● Mostly ◐ Partially ○ Minimally



Health Insurance Strong Recruitment and Retention Tool

- #2 reason employees chose to work for and remain with State (#1 was job stability & security)
- 96% of agencies agreed effective at recruiting employees who have families
- 80% of agencies agreed effective retention tool

State Health Insurance Compares Favorably to Other Large Employers

- Mercer ranked medical benefit portion of State health insurance
 - 4th compared to 16 large peer employers in VA
 - 2nd compared to 7 nearby states
- State contributes higher portion of premium than most other employers
- Out-of-pocket costs, such as deductibles, coinsurance, and copayments are similar or below median

Health Insurance Costs Are Growing Portion of State Spending

- Over past ten years has grown faster than total State appropriations (135% vs 99%)
- Grown as % of total compensation spending (10.8% to 13.5% from FY 2003 to FY 2007)
- However, cost growth trends are not unique to State
- Certain factors driving costs are outside State's direct control

Factors Within State's Control Driving State Health Insurance Costs

- State premium contributions
- Fixed cost provisions of plan (deductibles and copayments)
- Limited focus on efficiency
- Lack of health data

Finding

	<i>Purposes</i>			<i>Cost</i>	
	Recruit	Retain	Health & Productivity	Current \$ (millions)	Future \$ Risk Level
Health Insurance	●	●	◐	\$677	High

Scale of Purposes Achieved

● Mostly ◐ Partially ○ Minimally



Retirement Benefits Retain Longer-Tenured Employees

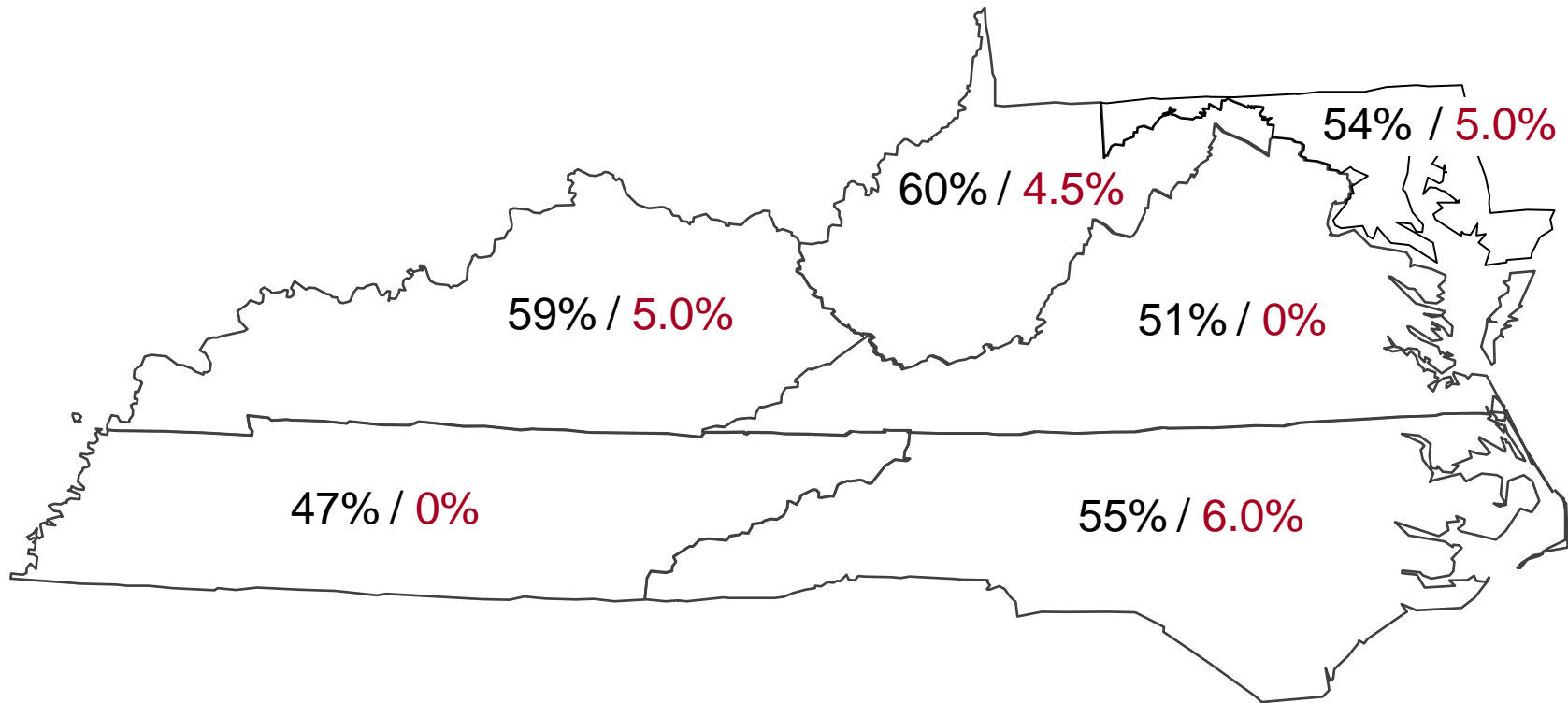
- 93% of agencies agreed
- 3/4 of employees within 5 yrs of retirement agreed
- More important for longer tenured than for recently hired employees (Mercer)

PWC and Mercer Found VRS Benefits Competitive With Other VA Employers

- PWC ranked the VRS benefit 3rd compared to 7 other large public & private employers in Virginia
- Mercer ranked VRS benefits 6th compared to 16 large peer employers in Virginia

Most Other Neighbor States Have Higher Income Replacement, But Employees Contribute

Income Replaced / Employee Contribution



Source: JLARC staff analysis of state retirement plan documentation, 2008.



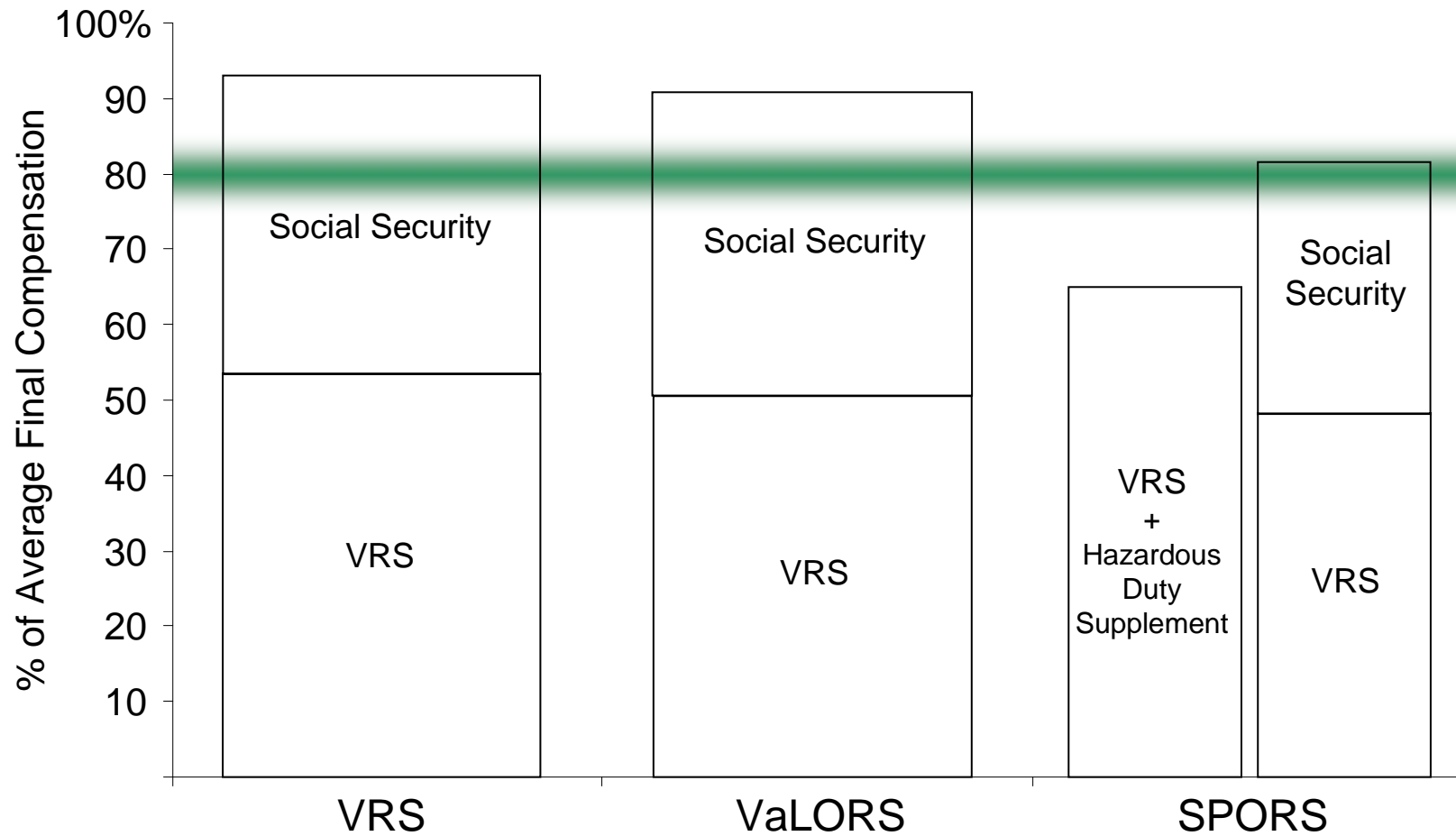
Majority of Retirees Retired Prior to Normal Retirement Age (Unreduced Benefit, 2000-07)

Plan	"Normal" Retirement Age	% Retiring Prior to "Normal" Age	Avg Age at Retirement	Avg Yrs Service at Retirement
Regular VRS	65	76%	62	30
SPORS	60	82	57	32
VaLORS	60	72	57	25

Source: JLARC staff analysis of VRS data, 2008.



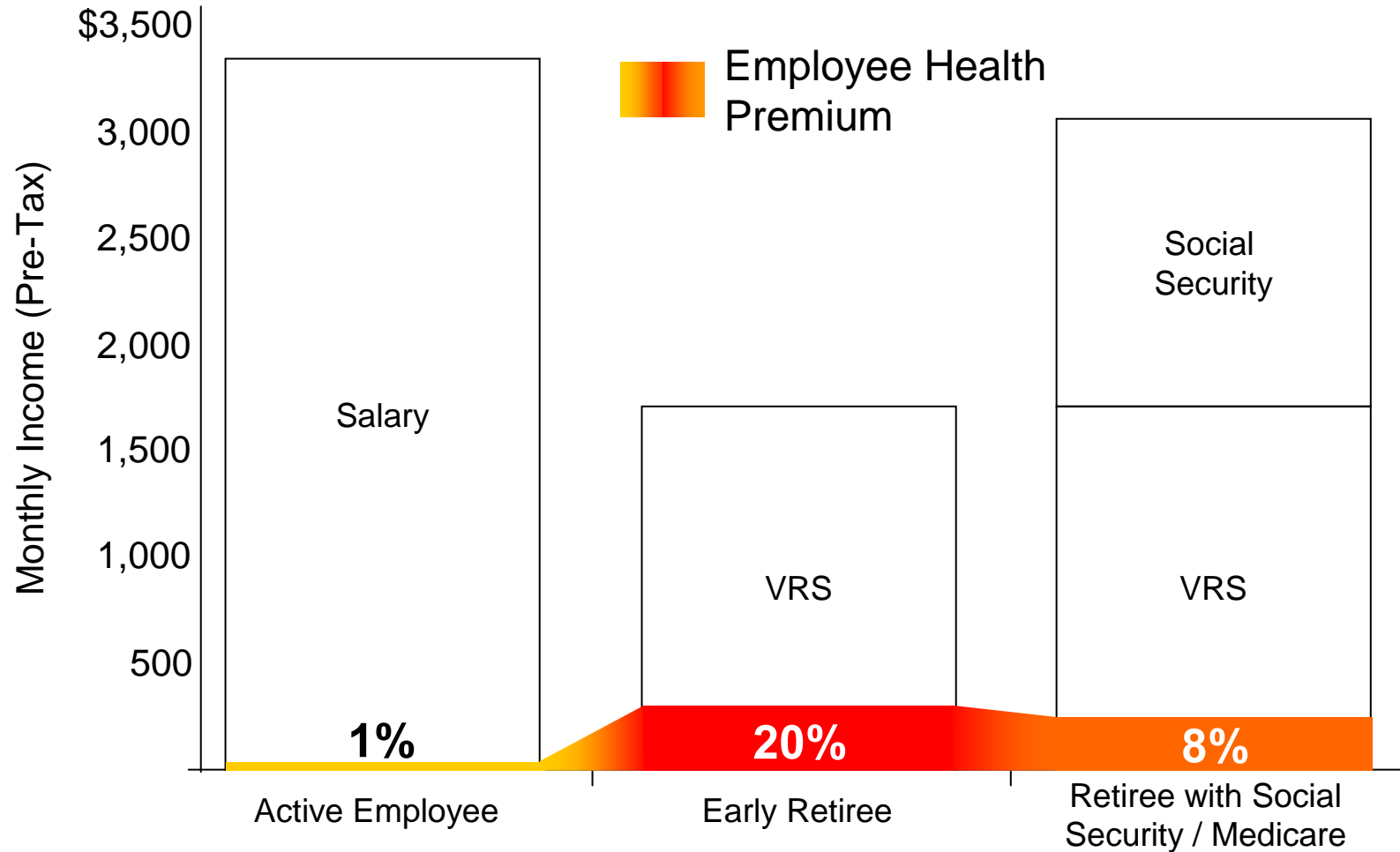
VRS and Social Security Benefits Replace More Than 80% of Pre-Retirement Income



Source: JLARC staff analysis of VRS and Social Security Administration data, 2008.



Employees Who Choose to Retire Early Face Large Increase in Health Costs as % of Income



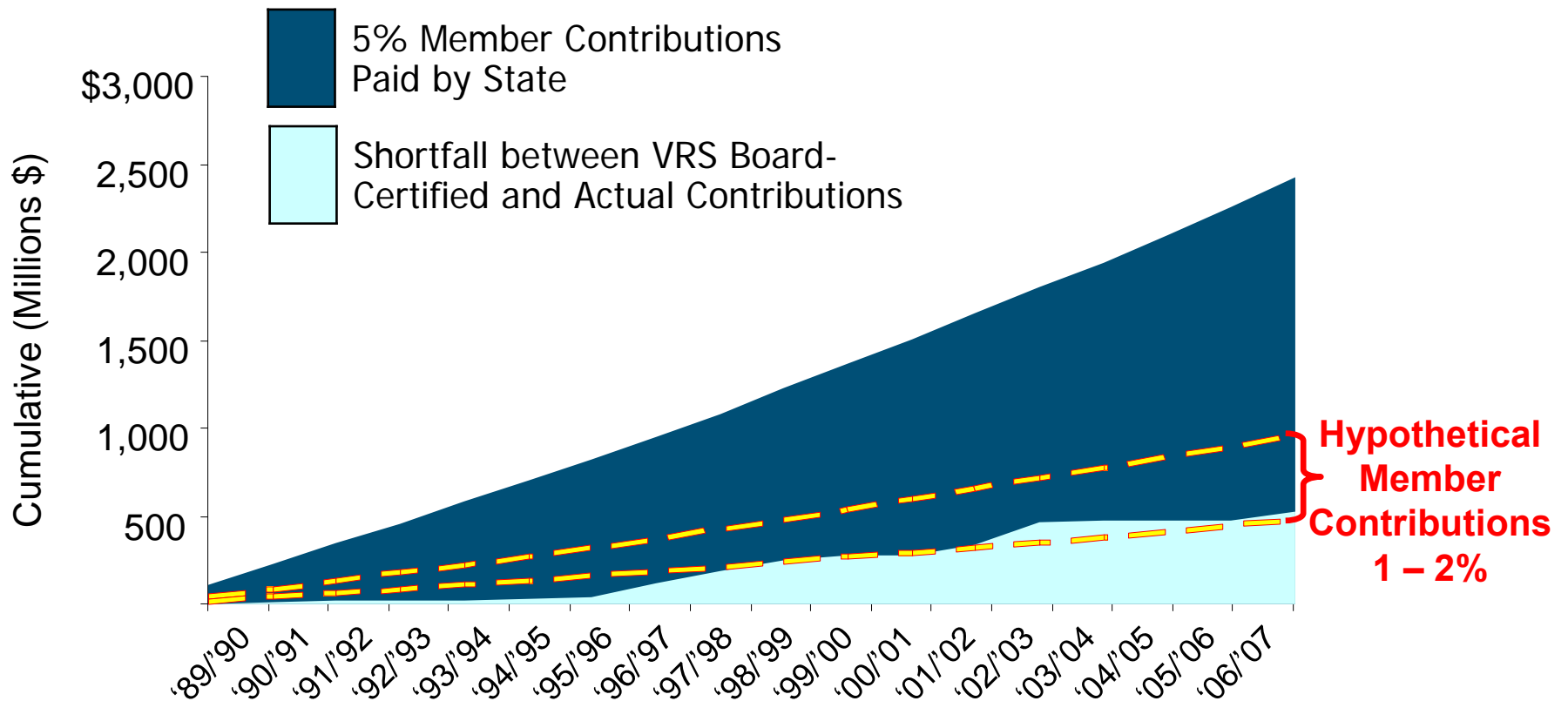
Contributions to VRS Plans Lower Than VRS Board Certified Rate in 10 of Last 18 Years

- Governmental Accounting Standards Board (GASB) recommends that employers fully pay Annual Required Contribution (ARC)
 - Compliance with GASB is factor in bond rating
- Virginia ranks 46th out of 50 states in average amount of ARC paid (Pew Center for the States)
- VRS funded status = 85.1%

PwC: State's Payment of Employee Contribution to VRS Benefits Is Unique and Costly

- Virginia unique in State payment of the employee portion of VRS costs
 - 4 other states have noncontributory plans
- "...the noncontributory nature of the VRS plan...significantly increases the value and cost of the VRS benefit." (PwC)
- State spent \$168.2 million in FY 2007, roughly 42% of total retirement contributions

Member Contributions of 1-2% Would Have Covered Shortfall in State Contributions



Source: JLARC staff analysis of VRS data, 2008.



PwC: COLA Protects Retirees' Purchasing Power But Is Cost Driver for State

- Without it, retirees would have lost about 2/3 of purchasing power over last 30 yrs
- Greater than COLAs granted by all neighboring state retirement systems
- Represents about 20% of plan costs (PwC)

Finding

	<i>Purposes</i>			<i>Cost</i>	
	Recruit	Retain	Retire	Current \$ (millions)	Future \$ Risk Level
Regular VRS	●	●	●	\$397	Med
SPORS	●	●	●	\$22	Med
VaLORS	●	●	●	\$68	Med

Scale of Purposes Achieved

● Mostly ◐ Partially ○ Minimally



Leave Benefits Effective Recruitment and Retention Tool

- 72% of agencies agreed
 - for single employees or with few yrs of service
- 86% agreed
 - for employees with families or more yrs of service

Leave Benefits Comparable to Other Large Employers

- Mercer ranked State's total leave
 - 9th compared to 16 large peer employers in VA
 - 3rd compared to 7 nearby states
- Slightly more holidays, but less sick leave
- 12th out of 14 for annual leave

Leave Benefits a Concern in 24/7 Facilities

- Over 1/3 of DOC and about 1/2 of DMHMRSAS facilities agreed leave reduces agency productivity
- DMHMRSAS and DOC employees least satisfied with work / life balance
 - Especially employees working evening, night, or rotating shifts

Finding

	<i>Purposes</i>					<i>Cost</i>	
	Recruit	Retain	Motivation & Morale	Health & Productivity	Work / Life Balance	Current \$ (millions)	Future \$ Risk Level
Leave Benefits	●	●	◐	◐	◐	\$24	Low

Scale of Purposes Achieved

● Mostly ◐ Partially ○ Minimally



Finding

	<i>Purposes</i>						<i>Cost</i>	
	Recruit	Retain	Motivation & Morale	Health & Productivity	Retire	Work / Life Balance	Current \$ (millions)	Future \$ Risk Level
Salary	●◐	●◐	●◐				\$3,301	Low
Health Insurance	●	●		●◐			\$677	High
Retirement Benefits	●	●			●		\$487	Med
Leave Benefits	●	●	●◐	●◐		●◐	\$24	Low

Scale of Purposes Achieved

● Mostly ●◐ Partially ○ Minimally [blank] N/A

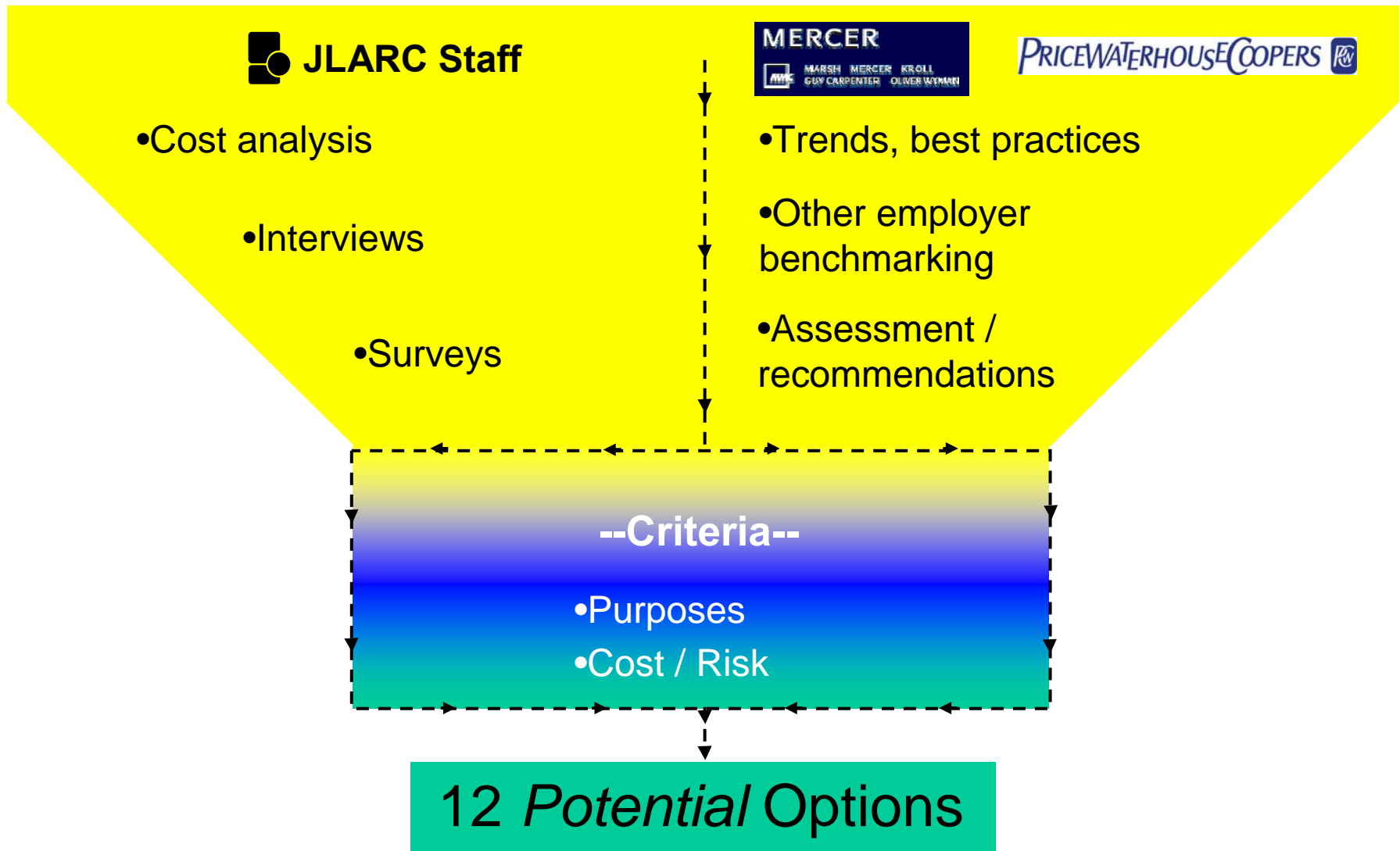


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JLARC Staff Used Information-Driven Process and Criteria to Identify 12 Potential Options



Finding

- JLARC staff identified criteria to assess agency budget requests for additional funds for salaries
 - Is salary achieving its purposes?
 - How do salaries (and benefits) compare to other employers?
 - What is the impact of inability to achieve purposes?

- JLARC staff review of recent agency budget requests for additional funding for salaries
 - Deciding exactly how to improve salary's ability to recruit, retain, and motivate is complex

Recommendation

- DPB should revise its Decision Package Narrative Justification form to require agencies requesting additional funds for employee salaries to address
 - extent to which current salaries are recruiting, retaining, and motivating employees
 - how total compensation compares to what is offered by other relevant employers for similar positions
 - impact on the agency's inability to provide services and recruit, retain, and motivate employees.

Illustrative Example of “Pay for Purpose” Approach to Agency Budget Requests

- Use scale to assess budget requests
 - First Tier
 - Most compelling and clearly documented case
 - Second Tier
 - Less compelling and less documented case than first tier

Salary Options

	<i>Purposes</i>			<i>Cost</i>	
	Recruit	Retain	Motivation & Morale	Projected Cost	Future \$ Risk Level
Moderate Pay for Purpose (S1)	↑	↑	↔	\$81 million	Higher
Aggressive Pay for Purpose (S2)	↑	↑	↔	\$284 million	Higher

Impact on Purposes

↑ Beneficial

↔ Minimal

↓ Harmful



Health Options Both Manage Future Growth of State Costs

- Moderate (H1) to more aggressive (H2) options
- Both options include changes that could be made to manage future cost growth
 - Health plans require ongoing and active management each year
- Illustrative examples of changes
 - Plan design
 - Premium contributions
 - Health management

Health Insurance Options

	<i>Purposes</i>			<i>Cost</i>	
	Recruit	Retain	Health & Productivity	Projected \$ Yr 5	Future \$ Risk Level
Moderate (H1)	↔	↔	↔	-\$46 million	Lower
Aggressive (H2)	↓	↓	↔	-\$116 million	Lower

Impact on Purposes

↑ Beneficial

↔ Minimal

↓ Harmful



Two Groups of Retirement Options

■ Moderate Options

- Options for change within existing structure
- Options R1 – R4

■ Aggressive Options

- Alternative retirement plan designs
- Options R5 – R7



Summary Impact of Moderate Retirement Options

	<i>Purposes</i>			<i>Cost</i>	
	Recruit	Retain	Retirement	Eventual Reduction in State Contributions (% of Payroll)	Future \$ Risk Level
Employee VRS contribution (R1)	↔	↔	↔	VRS = 1.95% SPORS = 1.98 VaLORS = 1.94	Lower
Reduced COLA (R2)	↔	↔	↔	VRS = 1.15% SPORS = 2.02 VaLORS = 1.31	Lower
New hire ret. age 60 (R3)	↔	↔	↔	VRS = 0.45%	Lower
New hire Integral Part Trust (R4)	↔	↔	↔	None	Lower

Impact on Purposes

↑ Beneficial

↔ Minimal

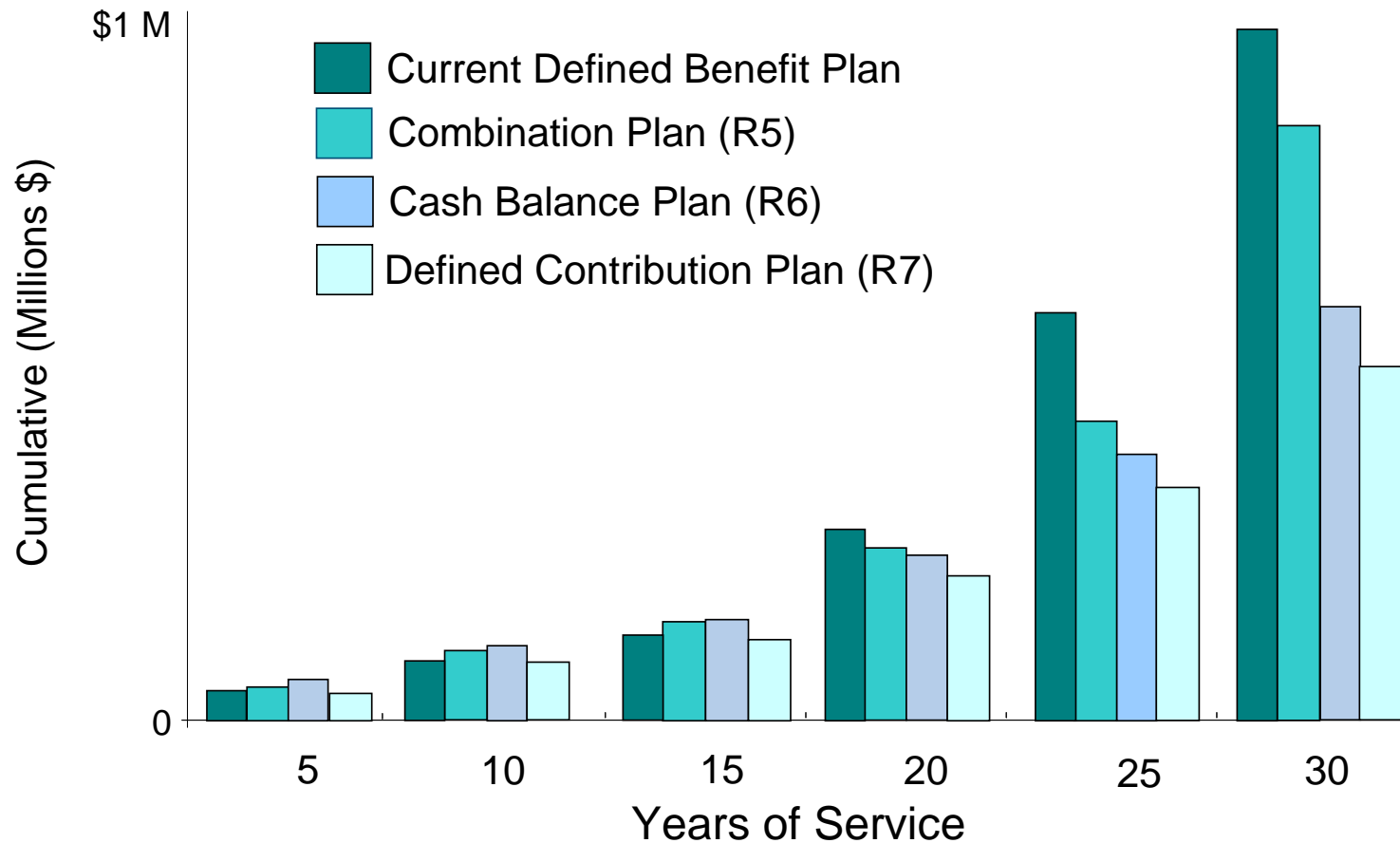
↓ Harmful



Aggressive Options: Alternative Retirement Plan Designs

- PwC and JLARC analyzed 3 alternative plan designs
 - Not applicable to SPORS and VaLORS
- All 3 alternative plans
 - Shift risk of saving for retirement to employees but reduce State costs over the long-term
 - Increase flexibility for shorter-tenured employees
- Analysis performed for State employees in regular VRS plan—consideration could be given to implementing for teachers and political subdivisions
- Would only be implemented for nonvested and newly hired employees

Options R5, R6, and R7 Provide Lower Value to Employees Later in Career



Source: PricewaterhouseCoopers, 2008.



Summary Impact of Aggressive Retirement Options

	<i>Purposes</i>			<i>Cost</i>	
	Recruit	Retain	Retirement	Eventual Reduction in State Contributions (% of Payroll)	Future \$ Risk Level
Create combination plan (R5)	↔	↔	↔	1.94%	Lower
Create cash balance plan (R6)	↔	↔	↓	3.33	Lower
Create defined contribution plan (R7)	↔	↔	↓	4.94	Lower

Impact on Purposes

↑ Beneficial

↔ Minimal

↓ Harmful



Leave Options

	<i>Purposes</i>					<i>Cost</i>	
	Recruit	Retain	Motivation & Morale	Health & Productivity	Work / Life Balance	Projected Cost (millions)	Future \$ Risk Level
Exchange leave for cash (L1)	↔	↔	↑	↑	↔	+\$18	Lower
Redistribute Leave (L2)	↔	↑	↔	↔	↔	+\$0.6	Lower

Impact on Purposes

↑ Beneficial ↔ Minimal ↓ Harmful



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JLARC Staff Used Three Main Criteria to Build Total Compensation Options

- Better achieve purposes of salaries and benefits / not unnecessarily harm State's ability to achieve purposes
- Improve sustainability of benefit programs / reduce level of future \$ risk / not lead to inefficient expenditures
- Increase employee choice / better align salaries and benefits with employee preferences

Option 1 Better Achieves Purposes and Reduces Future Cost and \$ Risk

	<i>Purposes</i>						<i>Cost</i>	
	Recruit	Retain	Motivation & Morale	Health & Productivity	Retire	Work / Life Balance	Projected \$ Yr 5 (millions)	Future \$ Risk Level
Mod. Pay for Purpose (S1)	↑	↑	↔				+\$89	Higher
Mod. health changes (H1)	↔	↔		↔			-\$46	Lower
Employee VRS contribution(R1)	↔	↔			↔		-\$91	Lower
Reduced COLA (R2)	↔	↔			↔		-\$55	Lower
New hire ret. age 60 (R3)	↔	↔			↔		-	Lower
Exchange leave for cash (L1.b)	↔	↔	↑	↑		↔	+\$21	Lower
Projected Total \$ Impact in Year 5							-\$82 million	

Impact on Purposes

↑ Beneficial ↔ Minimal ↓ Harmful [blank] N/A



Option 2 Includes Different Retirement Structure (New Hires / Non-Vested)

	<i>Purposes</i>						<i>Cost</i>	
	Recruit	Retain	Motivation & Morale	Health & Productivity	Retire	Work / Life Balance	Projected \$ Yr 5 (millions)	Future \$ Risk Level
Mod. Pay for Purpose (S1)	↑	↑	↔				+\$90	Higher
Mod. health changes (H1)	↔	↔		↔			-\$46	Lower
Create new combination plan (R5)	↔	↔			↔		-\$66	Lower
New hire IPT (R4)	↔	↔			↔		-	Lower
Exchange leave for cash (L1.b)	↔	↔	↑	↑		↔	+\$21	Lower
Projected Total \$ Impact in Year 5							-\$1 million	

Impact on Purposes

↑ Beneficial ↔ Minimal ↓ Harmful [blank] N/A



Summary

	<i>Purposes</i>						<i>Cost</i>	
	Recruit	Retain	Motivation & Morale	Health & Productivity	Retire	Work / Life Balance	Current \$ (millions)	Future \$ Risk Level
Salary	◐	◐	◐				\$3,301	Low
Health Insurance	●	●		◐			\$677	High
Retirement Benefits	●	●			●		\$487	Med
Leave Benefits	●	●	◐	◐		◐	\$24	Low

Scale of Purposes Achieved

● Mostly ◐ Partially ○ Minimally [blank] N/A



JLARC Staff for This Report

Glen Tittermary, Deputy Director

Justin Brown, Project Leader

Trish Bishop

Christine Wolfe

Tracey Smith

Janice Baab

Mark Gribbin

Shannon White

For More Information

<http://jlarc.state.va.us>

(804) 786-1258

