

MANAGEMENT

OBJECTIVE

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BACKGROUND

Ensure that compensation systems effectively control labor costs, improve employee productivity, and boost quality of services.

Rewards and recognition play an important part in motivating employees and improving performance. A carefully designed reward system can greatly enhance an organization's effectiveness and productivity. Today, complex reward systems are needed to meet the demands of a more diverse workforce. These systems differ both within and between organizations.

Increasingly, organizations are finding they must focus on the total compensation package for employees. Organizations are also developing more complex recognition programs which focus on non-monetary rewards for employees, such as employee-of-the-month and lunch-with-the-CEO programs.

In 1989, the Texas Incentive and Productivity Commission was created to administer the state employee incentive program and the agency productivity bonus program. These programs allow employees and their respective agencies an opportunity to receive additional monetary awards for making suggestions which lead to more efficient use of state resources.

The Position Classification Act of 1961 (Act) (Article 6252-11, V.A.C.S.) establishes a State Position Classification Plan (Plan) which covers most executive and administrative state agencies (hereinafter referred to as "classified agencies"). Under the Act, certain positions within these agencies may be exempted from the Plan. Institutions of higher education are also currently exempted. However, most higher education system offices and higher education institutions have implemented their own classification and compensation plans.

DEFINITIONS

Achievement bonuses are based on documented evidence of outstanding performance and do not enter into the employee's base salary.

Classification is a system of developing broad job classes which describe work that is being performed by a number of incumbents.

Compensation

- **Total compensation** is the complete pay package for employees including all forms of money, benefits, services, and in-kind payments (American Compensation Association, *Objectives*, p. 2.1, 1992).
- **Direct compensation** refers to the actual salary rates paid to employees for the work they perform.

Employee benefits constitute an indirect form of compensation that is intended to improve the quality of work life for employees.

Job analysis is a systematic process for obtaining important and relevant information about job content.

A **job description** is a summary of the most important features of a job, including the duties and responsibilities and the level of the work performed. It typically includes job specifications which are the knowledge, skills, and abilities required for competent performance of the job.

Job documentation refers to any written information about job content.

Job Evaluation

- **Market-based job evaluation systems** establish job-worth hierarchies based on external market data (the salary levels paid by other employers for jobs similar to their own). There are several different approaches to job content evaluation methods which can be categorized as either quantitative or non-quantitative.
- **Job-content methods of job evaluation** concentrate on the actual content of the job, which usually includes the responsibility assumed and the duties performed.

Merit increases permit the upward movement of an employee's salary to higher steps within a salary group. Merit increases reward an employee's performance while performing the same job.

Salary administration refers to the adjustment of employees' salaries after proper classification (or in some cases, exempt status) has been determined.

A **Salary schedule conversion** is an across-the-board increase that occurs at the beginning of a fiscal year. All classified employees in the same step in the same salary group as was occupied at the end of the previous fiscal year are converted to a

new salary amount. Salary schedule conversion may also occur whenever the state legislature grants approval for a percentage increase in the classified salary schedule.

Step adjustments increase an employee's base salary but are not necessarily based on performance. The entity determines the policy for step adjustments.

OVERVIEW OF THE PROCESS

The basic phases of a compensation and rewards process are:

Compensation and Rewards

- **Develop a compensation and reward system.**
- **Conduct a market survey to determine salary levels.**
- **Analyze entity's jobs.**
- **Document all job positions.**
- **Establish a job evaluation system.**
- **Compare job positions to job descriptions to ensure proper classification.**
- **Determine which positions are exempt from the classification status.**
- **Comply with the Fair Labor and Standards Act (FLSA).**
- **Develop a benefits program.**

Salary Administration

- **Define how employees move within the salary schedule.**

Payroll Administration

- **Establish and document a payroll administration process.**
- **Establish controls over payroll administration.**

PROCEDURES

Suggested procedures, organized according to the elements of a finding, are listed below. They should be expanded or tailored to fit the specific entity being reviewed.

**Review criteria:
Specific criteria**

The criteria related to the basic phases of the compensation and rewards process are as follows:

Compensation and Rewards**Develop a compensation and reward system**

Organizations should develop a compensation philosophy and system and adequate controls to ensure compliance with the system (American Compensation Association, *Objectives*, p. 1.2, 1992).

In state government, compensation rates are usually determined by a salary schedule (consisting of salary groups with minimum and maximum rate ranges and salary steps within the salary groups). For classified agencies, the Classified Salary Schedule is set by the Legislature for each fiscal year (General Appropriations Act, Article V, Section 1).

Conduct a market survey to determine salary levels

In order to properly use market data to establish a job worth hierarchy, the entity must identify the relevant markets for its own human resources and be able to collect external pay data on a majority of the organization's jobs. The process of collecting this data is known as "market pricing." Market data can also be used to supplement a more formal job content evaluation system (American Compensation Association, *Job Analysis*, pp. 4.1-4.16, 1992).

Analyze entity's jobs

In order for entities to develop a plan for how employees will be compensated, they must analyze each job. Entities should have a job analysis system to determine the duties and responsibilities of individual jobs and the knowledge, skills, and abilities required for positions (American Compensation Association, *Job Analysis*, pp. 2.1-2.61). Primary sources for job information include direct observation, individual or group interviews, diaries or logs, questionnaires, and technical consultations (American Compensation Association, *Job Analysis*, pp. 2.1-2.61, 1992).

Document all job positions

Organizations should have job documentation for each position which is based on job analysis (American Compensation Association, *Job Analysis*, pp. 3.1-3.53, 1992).

It is also important that the information gathered from job analysis is documented and communicated. While questionnaires, interview notes, diaries, logs, and efficiency study reports can be used as effective job documentation, job descriptions are the primary documentation used to detail job content. **Job descriptions should describe and focus on the job itself and not any specific individual who might fill the job** (American Compensation Association, *Job Analysis*, pp. 3.1-3.53, 1992).

Establish a job evaluation system

Entities should have a job evaluation system which determines the worth of the

position. After jobs have been analyzed and documented, organizations must evaluate them to determine their relative worth compared to other jobs within the organization. The objective of job evaluation systems is to provide a consistent measure of job worth. The two primary types of job evaluation are market-based and job content evaluations.

Compare job positions to job descriptions to ensure proper classification

At least annually, the entity should review job position responsibilities to ensure proper classification and compliance with the Position Classification Act. The entity should also review and update job descriptions to ensure they are current and reflect actual job tasks.

Determine which positions are exempt from the classification status

The entity should review the job positions and determine which positions are not included in the Position Classification Act of 1961 and may be considered exempt.

Comply with the Fair Labor and Standards Act (FLSA)

Entities must have a system to determine FLSA exempt or nonexempt status of employees (29 CFR § 541). The FLSA requires that all employees who are subject to its overtime provisions must be compensated at time-and-a-half for time physically worked in excess of 40 hours in a work week. Agencies and institutions must determine which of their employees are subject to the overtime provisions of the FLSA. Employees who are exempted from FLSA must qualify under the FLSA definitions as professional, administrative, or executive employees.

Develop a benefits program

Benefits must also be included as a part of total compensation for employees. Note that benefit costs are the fastest growing component of all compensation costs (Chruden, p. 462). The true measure of a successful benefits program is the degree of trust, understanding, and appreciation which it gains from the employees. In communicating with employees about benefits, information about complicated benefit components should be made clear to them to avoid misunderstanding as to what the plan will and will not provide (Chruden, p. 466).

The State offers a competitive benefits package compared to the national average when the costs as a percent of salaries are calculated. Among the many benefit programs the State offers are pay for leave time (vacations and holidays), health and insurance programs (workers' compensation, sick leave, and life, accident, and health), retirement programs (social security, private pension and retirement plans), and unemployment payment to employees (Texas State Auditor's Office, *Frequently Used Statistics*, p. 45, 1992).

Salary Administration**Define how employees move within the salary schedule**

After the entity determines the proper classification or exempt-from- classification status of all positions, certain salary administration actions can be taken which

affect employees' salaries. The following types of salary administration actions can be granted to an employee. (Definitions for these terms may be found in the General Appropriations Act, Article V, Section 1):

- salary schedule conversion
- promotions
- demotions
- reclassifications
- merit increases
- salary reduction for disciplinary reasons
- achievement bonuses
- step adjustments

These actions must be consistently applied and appropriately documented.

Payroll Administration

Establish and document a payroll administration process

Objectives of the payroll process include:

- Payroll transactions reported on the operating statement actually occurred during the period covered. Expenditures represent the exchange of cash or other consideration with the entity's employees for services received by the entity during the period.
- All transactions and accounts that should be included are included in the financial statements, and there are no undisclosed transactions.
- Payroll-related expenditures are included in the financial statements at appropriate amounts, are properly measured, and allocated to the correct period.

- Payroll-related expenditures are properly classified, described, and disclosed in the financial statements.

Establish controls over the payroll administration process

The entity must maintain records of all leave taken or accrued and the resulting leave balances. Payroll transactions records must be accurate, timely, and complete. Controls must be in place to ensure that the transactions are not lost or duplicated. Edit controls should be in place to validate critical data fields.

Duties for personnel (who make wage rate changes), timekeeping, payroll preparation, and distribution functions should be segregated.

Personnel files should be maintained and include support for employment authorization, pay rate, payroll deductions, and termination.

Timesheets and leave requests should require supervisory approval.

Physical security must be maintained over unissued warrants and checks.

Employees must receive accurate and timely reports of their earnings and leave balances (Texas State Auditor's Office, 1993).

**Assess Condition:
Determine the
actual process
used**

Conduct interviews, observe operations, and identify and collect available documentation in order to gain an understanding of the entity's actual compensation and reward process and controls. Included in the actual process are both official/unofficial and formal/informal processes and controls. An official process may exist even if it is not documented. Possible procedures include, but are not limited to:

- Determine how the entity developed its compensation and reward process and the relationship of the process to the strategic plan.
- Obtain and review any manuals, policies, and forms used for the compensation and reward process such as the employee payroll register, employee leave status reports, and timekeeping forms.
- Observe data entry into the timekeeping and payroll systems to determine what procedures are actually being used.
- Determine what type of compensation information is contained in the employee's personnel file.
- Determine how responsibilities are delegated in the payroll administration process.
- Review the information, if any, on the payroll process included in the SAO permanent file.

In addition to gaining an understanding of the actual process, also try to find out:

- how the participants view their own process
- what they think is important about the process, and why

This information may help identify causes and barriers.

Determine the strengths and weaknesses of the actual process

Using the tailored criteria, the understanding of the entity's process gained above, and the procedures in this section, analyze the actual process to determine if it:

- is designed to accomplish the management objective (this module, page 1),
- has controls that provide reasonable assurance that the process will work as intended,
- is implemented and functioning as designed, and
- is actually achieving the desired management objective(s).

In executing these procedures, remember to identify and analyze both strengths and weaknesses.

Identify and review the steps in the actual process. Possible procedures include, but are not limited to:

- Determine if all major steps in the criteria are included in the actual process.
- Determine if all the steps in the process appear to add value. If there are steps that do not appear to add value, try to get additional information on why they are included in the process.
- Review the order of the steps in the process to determine if it promotes productivity.
- Review the level of technology used in the process to determine if it is up-to-date and appropriate to the task.

Identify the controls over the process and determine if the controls are appropriate, placed at the right point(s) in the process, and cost effective. Possible procedures include, but are not limited to:

- Draw a picture of the process, the controls, and the control objectives (see the graphic of the procurement process in the [Introduction](#) for an example). Determine if the control objectives are in alignment with the overall management objective(s).
- Identify and evaluate the controls in place to make sure that the compensation and reward process promotes the objectives of the entity and positively impacts employees' careers.
- Determine if there are controls over classification decisions, e.g. a formal appeal process for employees who believe their classification is inappropriate.
- Identify and evaluate the controls used by the entity to validate and review its job position responsibilities to ensure that employees are properly classified.
- Identify and evaluate the controls used by the entity to validate and review its job descriptions to ensure that they reflect current job tasks.
- Look at the controls in place to ensure that payroll administration is done in a timely manner. Determine if they are appropriately placed in the process. (If the control is only at the end of the process, it won't be as effective in ensuring timeliness).
- Identify and evaluate the controls to ensure the security and data integrity of payroll information.

- Determine which payroll administration duties are segregated.

Review observations, interviews, documentation, and other evidence and design specific audit procedures as needed to determine if the process and/or controls are functioning as designed. Depending upon the objectives of the project, these procedures may include both tests of controls and substantive tests. Possible procedures include, but are not limited to:

- Compare the actual input of payroll and timekeeping data into the payroll system to documented policies and procedures.
- Review documentation of job descriptions and their classification level, and compare with actual job tasks performed.
- Review the tests, if any, conducted on payroll processes in conjunction with the statewide audit.

Analyze process reports over time for trends. Determine whether the information gained from the review of job responsibilities and tasks is fed back AND is used to ensure proper compensation and rewards. Possible procedures include, but are not limited to:

- Review report on grievances filed by employees. Determine if they indicate any overall weaknesses in the compensation and reward process.
- Review reports prepared by the Classification Division of the SAO. Determine what weaknesses, if any, are identified.

Determine causes

Determine what circumstances, if any, caused the identified weaknesses in the compensation and rewards process. Possible procedures include, but are not limited to:

- Determine if the participants in the compensation and rewards process understand its relationship to the entity's mission, goals, and values.
- Determine if the participants understand their role in the compensation and rewards process.
- If the process occurs at multiple locations, determine the nature and scope of the communication and coordination between them.
- Determine if the relationship between the compensation and reward process and other entity processes is clear.

- Determine if the compensation and reward process has adequate human, dollar, time, and asset resources.
- If there are negative trends in the monitoring reports, determine if the reports are communicated to and used by the appropriate parties.

Determine what internal or external constraints or barriers, if any, must be removed in order to successfully overcome these weaknesses. Possible procedures include, but are not limited to:

- Determine if any key employees are unwilling to change the process and why they are unwilling.
- Review the applicable entity, state, or federal laws or regulations to determine if any of them prevent the necessary changes from being made in the process.

Determine effect

Determine the effect of each of the identified weaknesses in terms of dollars, impact on services (either quantity or quality), impact on citizens, impact on the economy, etc. Possible procedures include, but are not limited to:

- Identify benchmarks for process in question and compare to actual performance. Quantify the difference, if possible.
- Estimate the cost before and after the proposed change and compare.
- Estimate the quantity and/or quality of services before and after the proposed change and compare.
- Identify the risks associated with not making the proposed change and quantify.

Develop recommendations

Use the tailored criteria, references in the resource section, the identified weaknesses, and the identified causes and barriers to develop specific recommendations to address the cause and correct the weaknesses. Possible procedures include, but are not limited to:

- Identify alternative solutions used by other entities.
- Identify solutions for removing barriers.
- Provide general guidelines as to the objectives the solution should meet so the entity can tailor it to its specific situation.
- Provide specific information, if available, on how each recommendation can be implemented.

RESOURCES

See the document titled "[Resources](#)" behind the last human resources module.