A Report
to the
Montana
Legislature

Performance Audit

Oversight of Discretionary Pay Changes for State Employees

Department of Administration

January 2017

Legislative Audit
Division

15P-05

Performance Audits

Performance audits conducted by the Legislative Audit Division are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Members of the performance audit staff hold degrees in disciplines appropriate to the audit process.

Performance audits are conducted at the request of the Legislative Audit Committee which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of six members of the Senate and six members of the House of Representatives.

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LEGISLATIVE AUDIT DIVISION

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January 2017

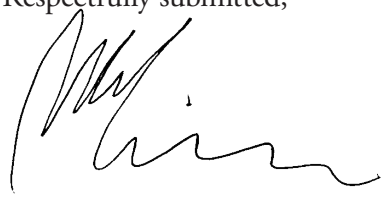
The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of oversight of discretionary pay changes for state employees. Discretionary pay changes are made by individual agencies under the guidance of State Human Resources Division of the Department of Administration.

This report provides the legislature information about the process for awarding discretionary pay changes to state employees outside of those directly provided by the legislature. This report includes recommendations for enhancing oversight of state employee discretionary pay changes by the Department of Administration, and recommendations to the legislature for clarification of statute related to pay adjustment analysis and usage. A written response from the Department of Administration is included at the end of the report.

We wish to express our appreciation to Department of Administration personnel and staff in multiple other state agencies for their cooperation and assistance during the audit.

Respectfully submitted,



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Montana Legislative Audit Division

Performance Audit
Oversight of Discretionary Pay Changes for State Employees
Department of Administration

January 2017 15P-05 Report Summary

In fiscal year 2015, state employees received over $9.5 million in additional compensation through discretionary pay changes. In Montana state government, these types of changes are administered by individual agencies with no oversight provided by the Department of Administration. Our work identified issues with the consistent application and support of discretionary pay changes to state employees, which could be remedied by a more proactive oversight role for DOA. Our work also identified issues related to statutory clarity for discretionary pay adjustments under the broadband pay plan.

Context

Within the broadband pay plan used by the majority of agencies of state government in Montana, each agency has its own pay plan that includes criteria for properly administering and supporting discretionary pay changes. Discretionary pay changes are those that are not directed by the legislature, and are at the discretion of the agency. Audit work included reviewing a sample of pay changes across ten agencies to determine if these pay changes were being properly and consistently supported by the agencies according to their pay plans and state policy. These agencies included the Arts Council, Department of Fish, Wildlife, and Parks, Department of Labor and Industry, Office of Public Instruction, Department of Public Health and Human Services, Department of Revenue, State Auditor's Office, Secretary of State, State Library, and Department of Transportation.

In fiscal year 2015 over $9.5 million in discretionary pay changes were granted throughout the state, as allowed under the broadband pay plan. Due to the decentralized nature of the broadband pay plan, there is no review process outside of the agencies for these pay changes, and audit work found they often did not meet the criteria established by the agencies, collective bargaining agreements, and state policy. State law requires the Department of Administration (DOA) to encourage and exercise leadership in the development of effective personnel administration within the state agencies. This includes the pay change process under the broad band pay plan. We also identified a lack of clarity in current statute regarding the funding and analysis of pay adjustments under the broadband pay plan. There is no statutory requirement for analysis of the effects of the broadband pay plan, and a lack of clarity in how funding should be provided for pay adjustments.

Results

We reviewed a sample of 200 pay changes and found that 173 were not properly supported. An unsupported pay change was one that did not follow the proper criteria based on agency policy, state policy, and/or union collective bargaining agreements. These 173 unsupported pay changes amounted to over $394,000 of the total of $503,921 in pay adjustments from the sample for fiscal year 2015. There were over 3,500 total pay changes awarded in fiscal year 2015. Instances that led to unsupported pay changes included agency pay plans that were contrary to state policy. In other cases pay plans did not include criteria for the types of changes that were being used by the agency. Presently there is

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no oversight of agency pay plans, pay changes, or entry of pay change information into the state accounting system on the part of DOA. Due to this decentralized process and limited oversight, audit work found that pay changes were frequently handled inconsistently between agencies.

This audit report makes four recommendations to improve DOA oversight of pay changes, and two recommendations to the legislature to enact legislation requiring ongoing examination, and clarification of the use of pay adjustments under the broadband pay plan. These recommendations relate to enhancing oversight and accountability for discretionary pay changes by:

- Taking a more active role in the pay change process including:
  - ◊ Clarifying state pay change policy, and
  - ◊ Providing training for pay changes.
- Establishing and implementing a biennial review process for agency pay plans based on state policy.
- Developing and implementing a pay change review process.
- Simplifying the pay change options available to agency staff.
- Enacting legislation to provide for an investigation of the effect of pay adjustments under the broadband pay plan.
- Clarifying state law on the use of pay adjustments under the broadband pay plan.

Recommendation Concurrence	
Concur	4
Partially Concur	0
Do Not Concur	0

Source: Agency audit response included in final report.

For a complete copy of the report (15P-05) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to **lad@mt.gov**; or check the web site at **http://leg.mt.gov/audit**
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Chapter I – Introduction and Background

Introduction

In 2001, the legislature passed legislation allowing for the development of the broadband pay plan. The broadband pay plan is an alternative compensation and classification plan that takes into account an analysis of labor markets through a biennial salary survey completed by the Department of Administration's (DOA) State Human Resources Division (SHRD). In 2007, the legislature passed legislation that required all positions, with a few exceptions, be grouped into occupations and these occupations placed in bands as part of the broadband pay plan. In 2008, a state pay task force was created to work on the ongoing issues related to the implementation of the broadband pay plan. According to DOA staff this task force directed them to maintain the decentralized system that is in place today, and minimalized DOA's oversight role in the broadband pay plan. Over 80 percent of state employees are included in the broadband pay plan. The broadband pay plan is set up to provide agencies with the flexibility to develop their own pay plans using any combination of discretionary pay changes they choose to best fit their agency. This allows agencies to determine which pay rules will best fit their unique missions. DOA, and more specifically SHRD, are charged with encouraging and exercising guidance to the agencies in the creation of their pay plans.

Based on legislative interest in the ability of state agencies to provide discretionary pay changes in addition to pay changes provided directly by the legislature to state employees, the Legislative Audit Committee prioritized a performance audit of how individual state agencies apply and support these pay changes. This chapter further discusses the scope of our audit work, and provides background information on the broadband pay plan and the use of discretionary pay changes.

What Is a Broadband Pay Plan?

The broadband pay plan is the pay plan that is used for over 80 percent of employees in Montana State government. It is a system for setting and adjusting the pay of state employees. The broadband pay plan is a pay plan system with nine wide pay bands with pay ranges that allow agency flexibility. Jobs are allocated to one of the nine pay bands based on classification standards developed by DOA. The broadband classification plan serves two purposes. It provides the means for identifying and grouping similar jobs to ensure internal pay equity, and matches jobs for external pay comparison. Trained classifiers at the agencies put each position into an occupation, which is then put into a pay band. DOA then identifies market midpoints for all occupations through a biennial salary survey. This analysis provides a gauge for agencies to compare the pay they are offering to relevant external labor markets. DOA then uses the market midpoints to create competitive pay zones for occupations. Agencies are not required

to use this information, and they may create their own pay ranges for the occupations in their agencies. It is up to the agencies to decide if they want to tie pay to DOA's market analysis.

State policy maintains broadband pay plan rules must be fiscally responsible, actively managed, and consistent with the agency's mission and objectives. This flexibility allows state agencies the ability to link employee compensation to the agency's mission, which gives agency managers a greater opportunity to actively manage their employees through the use of pay changes. This is in contrast to a more traditional government system which relies on years of service to determine who is in line for pay increases. The greater latitude for managers can be beneficial; however, it can also lead to a decentralized process with less accountability. Since pay changes are largely carried out at the agency level, the potential for inequities in how agencies apply pay changes across the state is increased. While discretionary pay changes at the agency level are allowable within the state's broadband pay plan, the decentralized nature of the pay plan diminishes accountability to the legislature.

Pay Changes Within a Broadband Pay Plan

One of the main features of a broadband pay plan is that agency managers have more influence on pay progression and changes for individual employees. They can choose the pay change types that will best empower their employees to accomplish their mission. The pay changes should be implemented based on criteria in agency policy, state policy, and/or union collective bargaining agreements. In fiscal year 2015, and over the last several legislative sessions, funding for statutory pay increases has largely been given in either across-the-board (i.e. to all state employees) percentage increases, or across-the-board dollar amount increases. In order for the broadband pay plan to offer agencies the intended flexibility to more actively manage employees, these statutory pay increases would have to be given to the agencies in a lump sum and distributed according to the pay change options in the agencies' individual pay plans. When legislative increases are offered across the board, individual state agencies can only use pay change options in their pay plans for discretionary pay changes that are in addition to the legislative increases. This is currently how the pay change options in the broadband pay plan are being used by agencies. The across-the-board pay change currently offered by the legislature limits an agency's ability to use its pay plan to advance the agency's mission. The current system leads to limited use of pay changes, and less emphasis within the agency on how it will carry out pay changes. This, along with limited oversight, has led to inconsistencies in the pay change process in the agencies.

Pay Change Options in State Policy

According to state policy there are different types of pay changes available to agencies to include in their pay plans. Pay changes outside of pay adjustments are not fully at the discretion of the agencies, but still affect employee pay. Pay adjustments are a type of pay change that is available to agencies to distribute at their discretion. Statutory adjustments are given to all state employees under the broadband pay plan. Table 1 shows the number of statutory pay raises that were given across the board, the number of pay changes outside of pay adjustments, the number of pay adjustments, and the costs associated with each for fiscal year 2015.

Table 1
State Employee Pay Changes and Adjustments
Fiscal Year 2015

Statutory Raises	**Number Awarded**	**Annual Cost FY15**
HB 13 Statutory Pay Raises	11,148	$ 25,282,400
Pay Changes	**Number Awarded**	**Annual Cost FY15**
Training Assignments	81	$ 184,662
Promotions	327	1,886,851
Temporary Promotions	94	730,080
Reclassifications	137	551,554
Career Ladder	323	873,496
Other	261	493,771
Total	**1,223**	**$ 4,720,414**
Pay Adjustments	**Number Awarded**	**Annual Cost FY15**
Competency	61	$ 189,509
Market	1,913	3,704,542
Performance	203	351,291
Results	Not an Option in SABHRS	
Situational	52	78,437
Supervisory	22	81,203
Strategic	92	459,014
Total	**2,343**	**$ 4,863,996**
Grand Total of Pay Changes and Adjustments	**3,566**	**$ 9,584,410**

Source: Compiled by the Legislative Audit Division from SABHRS data.

The table shows that while not directly appropriated by the legislature, pay changes and adjustments represent a considerable annual cost to the state. Each of the pay changes has its own criteria and situation for when it is appropriate to use in state policy. This is meant to be supplemented by further criteria in the individual agencies' pay plan policies to determine when they are appropriate to use.

Audit Scope and Objectives

In 2011, the legislature did not provide funding for pay plan increases for state employees for the 2013 biennium. However, under the authority granted by the broadband pay plan, agencies still granted some employees pay changes to provide for an increase in pay. Consequently, the 2013 Legislature requested information on how these pay changes were given without legislative authority by passing House Joint Resolution 17, which was a study resolution of state pay plans. Research on the broadband pay plan was carried out by the Legislative Fiscal Division (LFD) for the Legislative Fiscal Committee (LFC). LFD presented information on data related to pay plans, funding for pay increases, pay plan options, personal service analysis, and general information on pay plans. Based on LFD's work, LFC requested a performance audit to look further into the decentralized pay change process. This request was then prioritized by the audit committee. Based on audit assessment work, we determined that while state agencies do have the ability to provide discretionary pay changes as part of the broadband play plan, the pay change process is decentralized, with limited oversight provided by DOA.

As a result, we examined how state agencies apply and support these changes. This review was conducted on pay changes from fiscal year 2015. This included only those employees who are under the broadband pay plan. Audit staff also examined the distribution of discretionary pay adjustments across state agencies. Pay adjustments are a type of discretionary pay change that agencies may use to change an employees pay. Pay changes are defined as discretionary because agency staff are able to give them to employees at their discretion without specific funding from the legislature. All pay changes discussed in this report are discretionary unless otherwise specified. Based on our audit assessment work, we developed the following two audit objectives for examining and providing information on pay changes:

1. Determine if state employee pay changes are applied and distributed according to agency policy, state policy, and state law.
2. Determine the distribution of pay adjustments amongst state agencies and their employees.

Audit Methodologies

To address these objectives, we completed the following methodologies:

- Obtained and reviewed statutes and state policy related to pay changes to determine requirements for discretionary pay changes.
- Obtained fiscal year 2015 pay change information from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) to create a sample for file review.
- Created a random sample of 200 pay changes that were selected proportionately from the Arts Council, Department of Fish, Wildlife, and Parks, Department of Labor and Industry, Department of Transportation, Office of Public Instruction, Department of Public Health and Human Services, State Auditor's Office, Secretary of State, State Library, and Department of Revenue. These agencies were randomly selected from all agencies with employees on the broadband pay plan. This allowed for an assessment of pay changes statewide.
- Obtained copies of broadband pay plan policy and collectively bargained union contracts for all agencies sampled as criteria for file review.
- Conducted file review at those ten randomly sampled agencies based on our random sample of pay changes to determine if pay changes met criteria.
- Conducted interviews with human resource staff at the ten agencies following the file review to answer any related questions.
- Conducted an interview with DOA staff to discuss file review findings.
- Conducted a survey of agency human resource staff in order to gauge their understanding and opinions of state employee pay changes.
- Reviewed other states' pay plan polices regarding pay changes to determine criteria for best practices.
- Interviewed DOA staff to determine what information is available in the SABHRS data of statewide pay adjustments to assist in statewide review.
- Determined the primary funding source for all state agencies' personal services and the agency in general. Information was used to determine if there was a correlation between funding and ability to give pay adjustments.
- Used pay adjustment information from fiscal year 2015 to analyze data to determine trends in pay adjustments used by agencies.
- Interviewed DOA staff regarding the results of the statewide pay adjustment data analysis to gather information about the results.

Report Contents

The remainder of this report includes chapters detailing our findings, conclusions, and recommendations. It is organized into three additional chapters:

- Chapter II discusses the need for additional policy related to pay change types available to agencies, and training on how to properly support and record pay changes.
- Chapter III discusses pay plan and pay change inconsistency, and the need for oversight of agency pay changes and pay plans.
- Chapter IV provides an analysis of the statewide distribution of pay adjustments, and legislation changes needed to provide for ongoing analysis and clarification regarding pay adjustments under the broadband pay plan.

Chapter II – Addressing Pay Change Inconsistency

Introduction

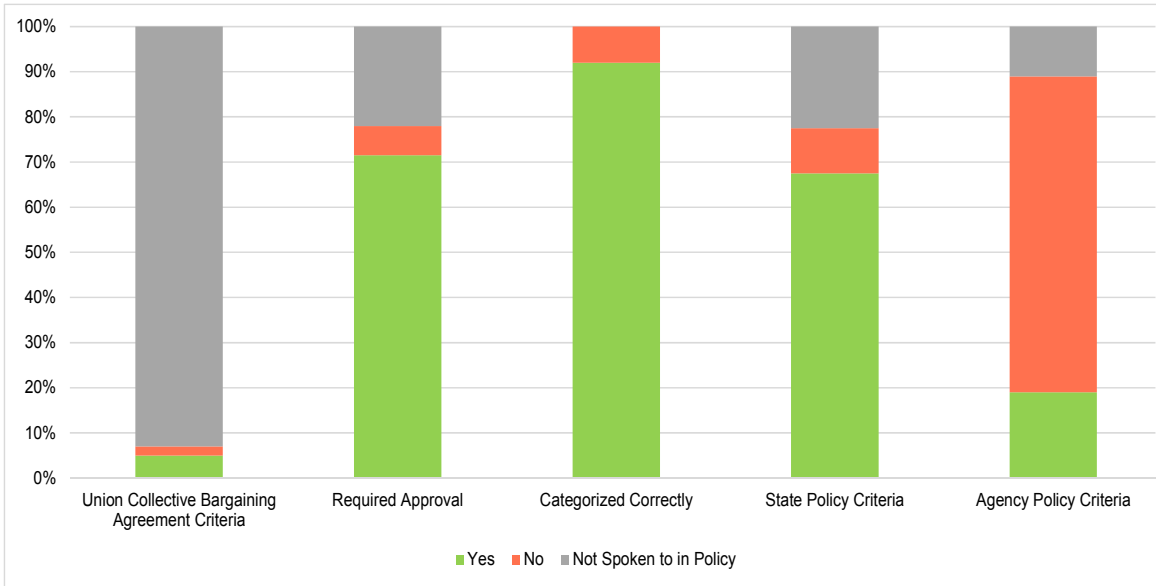
As part of our first objective, we examined how individual state agencies apply and support pay changes, based on requirements in agency play plans, state policy, and collective bargaining agreements. We found that pay changes were applied inconsistently across the sample of state agencies reviewed. The broadband pay plan is set up to allow agencies the flexibility in their individual pay plans to decide what types of pay changes they will use, and to a large extent, how they will be carried out. We found that the current level of guidance provided by Department of Administration (DOA) is not leading to consistently supported pay changes in state agencies. Currently, there is confusion within the agencies as to how to properly implement and support pay changes based on state and agency requirements. Our work indicated that DOA should clarify through state policy what pay change types are available to the agencies, and the criteria associated with each. The current system for pay changes is being carried out based on agency policy that is not actively managed, unclear state policy, and by agency employees that are in some cases not properly trained on how to support pay changes. Our work identified the need for DOA to provide additional guidance for state agencies when using pay changes. Agencies must be receptive to DOA guidance in order for them to correct agency-level documentation to properly support pay changes. This chapter presents our findings and recommendations in this area.

Pay Change File Review Found Inconsistencies Across State Agencies

Each agency has its own pay plan that allows it to decide which pay change types it wishes to use. Each individual agency is then responsible for documenting pay changes to show that they meet the agency's pay plan policy, state policy, and union collective bargaining agreements (CBA). This information is kept in each employee's personnel file to verify that the pay change was justified. For example, a performance pay change would require a copy of the performance evaluation that led to the pay change as well as any other documentation required by that agency's pay plan policy. The documentation required by the agency pay plan differs between agencies. That level of decentralization without oversight has led to inconsistencies in the application and support of pay changes. In order to better understand the pay change process at the individual agencies, audit work included a review of a sample of pay changes. This consisted of reviewing 200 randomly sampled pay changes from ten randomly sampled agencies. The 200 randomly sampled pay changes were chosen based on each

of the ten agencies proportion of the total number of pay changes statewide in fiscal year 2015. This allowed audit staff to review pay changes from a variety of agencies in order to determine if they were properly supported based on agency policy, state policy, and union CBA. Union CBA superseded state and agency policy where they conflicted, and state policy superseded agency policy when establishing criteria for the review. This review included large and small agencies with a variety of funding sources and management structures. Audit work determined that pay changes are supported with little documentation, so human resource staff could not always demonstrate pay changes followed agency pay plan policy, state policy, and union CBA. There was also general confusion among agency staff as to what situations required which type of pay changes. Agencies in some cases had differing criteria for the same pay changes. This led to an inconsistent application of pay changes across the state. The following figure represents the different areas in which file review found issues with agency pay changes.

Figure 1
Percentage of Sampled Pay Changes That Met Policy Requirements



Source: Compiled by the Legislative Audit Division from the ten agencies' records.

File Review Results Show a Large Percentage of Unsupported Pay Changes

The figure above represents the results of the file review when evaluated against each source of criteria. Overall, the file review found inconsistent support for pay changes throughout the sample. The following bullets represent each of the criteria sources, and

if support documentation for the pay changes satisfied the various requirements for proper support of pay changes.

- Union Collective Bargaining Agreement Criteria
  - ◊ CBA rules create criteria that must fall within statutory limitations, but supersedes agency pay plans. It was not common for the CBA to speak directly to pay changes, and this is represented by "Not Spoken to in Policy" in the figure. This made it rare for there to be criteria in the CBA to compare against for the file review of pay changes. Issues found with regard to CBAs were centered around incorrect effective dates for reclassifications that led to a pay change. For example, the Department of Health and Human Services (DPHHS) had a reclassification with an effective date after the first day of the pay period that is required by the CBA, meaning that the pay change went into effect after the date policy required.
- Required Approval
  - ◊ Based on the agency, there was approval required from different management at the agency if it was required at all. This ranged from the director to the manager of the employee receiving the pay change. Approval for pay changes was only required in eight of the ten agencies' pay plans, and only for some types of pay changes in the agencies that did require it. Those pay changes that did not require approval are represented by "Not Spoken to in Policy" in the figure. In general, agencies satisfied this requirement, but the fact that it was only required by some agencies, for some types of pay changes, creates another inconsistency and lack of oversight.
- Categorized Correctly
  - ◊ Audit work found that 8 percent of pay changes were not categorized correctly in our sample based on definitions in state policy. This means that based on the situation, the correct pay change type was not entered into the Statewide Accounting, Budgeting, and Human Resources System (SABHRS), which serves as the record for pay changes. This can lead to incorrect support for a pay change based on the wrong criteria, as well as errors in the SABHRS statewide data on pay changes.
- State Policy Criteria
  - ◊ This criteria was available for most types of pay changes. However, it does not speak to pay changes such as career ladder changes, which are used by some agencies. Pay change types that were not spoken to in state policy are represented by "Not Spoken to in Policy" in the figure. For other pay change types state policy offered limited criteria. Agencies failed to meet the limited state policy in some cases. For example, the State Auditor's Office had a performance adjustment without any documentation to determine if state policy criteria was met. State policy was limited in guidance of how to properly support the various pay change options, and in some cases agency staff indicated they found it difficult to determine the difference between the types of pay changes.

- Agency Policy Criteria
  - ◊ This criteria was the reason why a large portion of the pay changes fell short of proper justification. We found 140 pay changes that did not meet the criteria established in agency pay plan policy. There were also 22 cases in which a pay change type was awarded even though the agency's plan did not include that type of pay change. This means that there was no established criteria for that pay change type at the agency level, and thus it could not be determined if it was properly justified. For example, the Department of Revenue did not have policy for strategic adjustments even though it used this type of pay change. This is represented by "Not Spoken to in Policy" in the figure. Oversight by DOA will help agencies more consistently support their pay changes, but agencies are still responsible for interpretation and compliance with their agency pay plan policies.

We found that 173 out of 200 (86.5 percent) of the changes in pay were not properly supported. Our work identified numerous inconsistencies among agencies regarding what criteria they required to justify a pay change, if there was criteria at all. These issues stem from limited state policy outlining what type of support is required for pay changes.

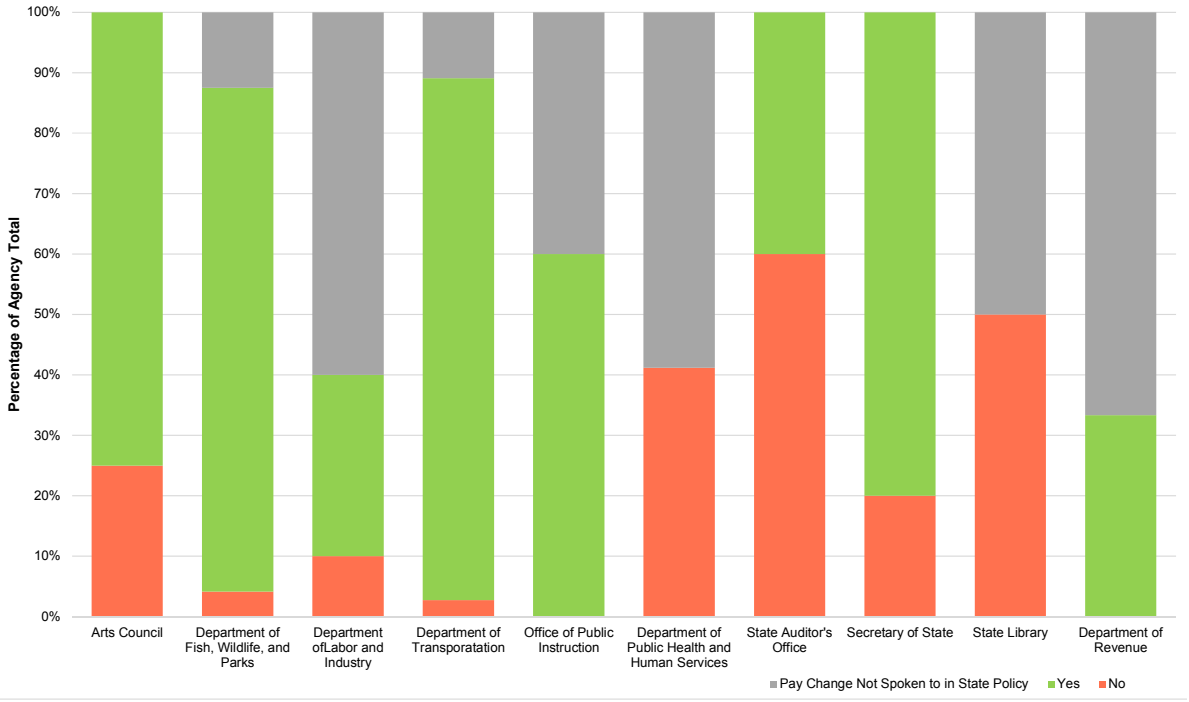
DOA Provides Limited Guidance Regarding Proper Pay Change Procedure

The file review established the basis for the findings made regarding the inconsistent application of pay changes at the agency level. This resulted, in part, from a lack of clear guidance from DOA and agency knowledge regarding proper pay change support. This contributed to agency pay change processes that do not properly support pay changes. Since Montana has a system in which pay changes are carried out exclusively by the agencies, it magnifies the importance of clear guidance on how pay changes should be carried out. Since state policy is not clear, proper support for pay changes has been left up to the interpretation of the individual agencies. This has resulted in pay changes with limited documentation, and some that are not documented at all. For example, in our review we found that DPHHS gave across-the-board situational adjustments to everyone in a certain position at a regional office. According to staff this was done to alleviate union employee concerns that an individual with less experience was started at a higher wage in that position, or to alleviate recruitment and retention issues. There was no documentation to support the pay change, nor determine why it was given. If it was to alleviate recruitment and retention issues it was also categorized incorrectly, and likely should have been a strategic adjustment.

According to DOA, the list of pay changes in state policy are categories under which agencies can create pay change types in their agency pay plan policies. We found that agencies mainly use the pay change types in state policy. This is contrary to DOA's representation that state policy has pay change categories. This ambiguity by DOA highlights the need for improvement in state policy to provide more specific guidance to agencies regarding what pay change types they can include in their pay plans. We also found that there are fewer pay change options available in SABHRS than in state policy. Agency staff have to choose a pay change option when entering the pay change information into SABHRS. Agency staff have a list of pay change types available to them in SABHRS when they are recording a pay change. If there are more pay change types available to agencies in state policy than in SABHRS this further creates inconsistency. In these cases, agencies do not have a way to accurately report those pay changes in SABHRS.

Figure 2 (see page 12) shows there were considerable differences between pay change criteria in state policy, and the support and type of pay changes used by the agencies. Those cases when audit work determined that a pay change was "Not Spoken to in Policy" it meant that the type of pay change used by the agency did not have criteria for proper support in state policy. In these cases state policy did not establish base criteria for support of the pay change, so it was at the discretion of the agency to decide what constituted proper justification. A "No" means that the documented support the agency had for the pay change did not meet the criteria established by state policy.

Figure 2
Percentage of Pay Changes That Met State Policy Requirements
Agencies Reviewed



Source: Compiled by the Legislative Audit Division from the ten agencies' records.

Inconsistency in Agency Use and Interpretation of Pay Change Policy

Interviews with agency staff responsible for pay changes made it clear that there was confusion about the various types of pay changes in state policy. In some cases they indicated that the differences between different types of pay changes were unclear. For example one interviewee indicated they consider performance and competency adjustments to be essentially the same thing. State policy indicates that competencies must be identifiable, observable, measurable, and comparable to like positions for internal equity, while saying that performance adjustments must have a corresponding performance appraisal that supports the pay change. This makes it difficult to determine what scenarios require which pay change types.

In other cases it was unclear what type of pay change was being used by the agency. DPHHS had several pay changes that were unclear as to why the type of pay change listed in SABHRS was selected. Staff could not explain why the specific pay change type was selected in SABHRS, and the pay change support was not thorough enough

to provide any clarification. This partially stems from a lack of base support established by state policy that must be included in agency pay plans. Agency responsibility for maintaining clear pay plans should not be overlooked, but state policy must be clear on the minimum standards for agency pay plans to justify pay changes. This would not affect an agency's ability to determine which pay changes it can include in its pay plan, or when to award pay changes to employees. State policy clarification would provide clear guidance on how to properly support those pay changes.

DOA Does Not Provide Active Oversight for Agency Pay Changes

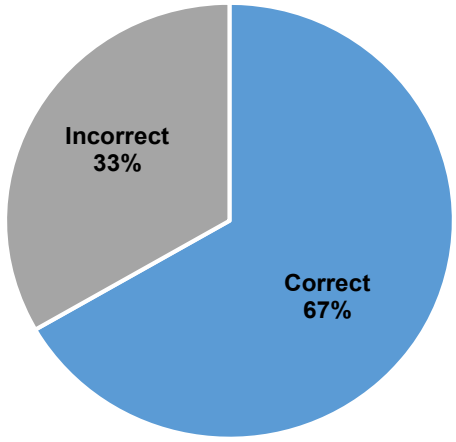
Interviews across state agencies made it clear there is confusion regarding the pay change process. In order for agency staff to properly support pay changes they need to have a good understanding of state policy. Because of the decentralized nature of the pay change process in Montana, there is a reliance on agency personnel to have a thorough understanding of how to properly support pay changes. In many cases it was clear that agency pay plans and state policy were not commonly consulted during the pay change process. For example, DPHHS regional offices conduct their pay change process internally at those offices without any review by the agency's central human resources staff. This can lead to individuals with little understanding of the pay change process being responsible for proper support of the pay change. In one example, agency staff indicated that an individual approving pay adjustments was from the private sector and did not fully understand the pay change process. This was a case of an untrained individual being responsible for the pay change process without any oversight from DOA, or agency staff who were more familiar with the pay change process. It is agency responsibility to be familiar with the agency pay policy and to have a system in place for proper review of pay changes by qualified staff.

Survey of Agency Personnel Indicates Need for Pay Change Training

As part of audit work we sent out a survey to 199 agency HR staff at 24 agencies who work with agency pay plans, or pay change administration. We received 98 responses to the survey for a response rate of 49 percent. The survey asked questions regarding agency pay plans and pay change administration. This helped us gain broader insight into the understanding of pay changes at the agency level, beyond the ten agencies in the file review sample. The survey results made it apparent there is not a clear understanding of the different pay change types. As part of the survey, agency staff were asked to identify a competency adjustment, entry to pay band adjustment, results adjustment, and strategic adjustment based on the current definitions in state policy.

Figure 3 shows the total percentage of correct and incorrect responses from those four questions combined. One-third of agency staff responding to this section of the survey could not correctly identify the pay change types based on their definitions currently found in state policy.

Figure 3
Pay Change Types Incorrectly Identified Based on the State Policy Definitions



Source: Compiled by the Legislative Audit Division from survey data.

The Decentralized Nature of the Pay Plan Makes DOA Guidance Crucial

As part of our audit work, we reviewed the application and support of pay changes in other states, including Wyoming, Idaho, Utah, and South Dakota. We noted that other states generally have a centralized HR approval process for pay changes that acts as a check to determine pay changes are properly justified. For example, in Idaho a centralized executive branch policy indicates when a pay change may be given, and all pay plans and pay change rules are approved centrally.

In contrast, the final determination is made at the agency level in Montana. This makes clear policy even more important than it would be in the other states systems with a centralized decision making process for pay changes. State policy indicates that agency pay policy must identify procedures for implementing all aspects of pay addressed in state policy. DOA must provide agencies with pay plan policy that is clear enough for them to understand how to satisfy this requirement. This is part of DOA's statutory requirement in §2-18-102 to encourage and exercise leadership in the development of effective personnel administration within the several agencies in the state.

Clear State Policy and Training Will Improve Pay Change Consistency

Audit work highlighted the need for training, and clarification of policy with regards to the pay change process. Current policy is leading to confusion within state agencies, and this confusion is leading to inconsistency in the pay change process. Montana's decentralized pay change system creates a need for a level of expertise in each agency regarding how to properly implement and support pay changes. In order to provide assurance that pay changes are being handled properly there must be more specific state policy criteria, and training provided by DOA to state agencies on how best to implement this criteria.

RECOMMENDATION #1

We recommend the Department of Administration take an active role in the pay change process by:

A. *Developing and implementing additional policy to determine what pay change types are available to agencies.*

B. *Establishing minimum levels of documentation for support and justification of pay changes.*

C. *Developing and providing training to agency staff on proper pay change procedure, including how to properly support and implement pay changes based on updated state pay change policy.*

SABHRS Action Reason Codes Are Creating Data Entry Inconsistency

As part of documenting any pay change, individual agency staff are required to enter each pay change into SABHRS to record what type of pay change was given, the amount of the pay change, and other information related to the individual receiving the pay change. This creates the official record of pay changes statewide. Agency staff are relied upon to determine the appropriate pay change type for the situation based on limited guidance provided by DOA that is infrequently referenced by agency staff. This leads to issues at the agency level regarding consistent entry of pay change information into SABHRS.

Guidance from DOA Is Unclear

State policy includes a list of all of the available pay change types that agency staff choose from to enter a pay change into SABHRS. There are currently 26 different codes they can choose from. Table 2 (see page 16) shows each of the codes that agency staff have to choose from when entering a pay change into SABHRS.

Table 2
SABHRS Pay Change Codes

Action	Reason	Description
PAY	BCR	Blue Collar Pay Raise
PAY	STA	HB 13 Statutory Pay Raise
PAY	CAR	Career Ladder
PAY	COM	Competency Adjustment
PAY	COR	Correct Inaccurate Pay
PAY	EMG	Emergency Firefighters-DNRC
PAY	EXM	Exempt Employee Raise
PAY	JUD	Judicial Branch Pay Change
PAY	MHP	MHP-HB 35 & Progression Raise
PAY	MAR	Market Adjustment
PAY	MER	Merit-Legislative Branch
PAY	MRT	Merit-State Fund
PAY	MIL	Military Pay Change
PAY	MEB	Move to Entry of Pay Band
PAY	NPS	Negotiated Pay Schedule
PAY	NRS	Per Diem Nurse Pay
PAY	NRE	Per Diem Nurse Pay End
PAY	PRP	Performance Adjustment
PAY	PRE	Performance Pay End
PAY	REC	Reclassification
PAY	SIT	Situational Adjustment
PAY	SIE	Situational Pay End
PAY	STR	Strategic Adjustment
PAY	SUP	Supervisory Adjustment
PAY	SUE	Supervisory Pay End
PAY	TAP	Training Assignment Progression

Source: Compiled by the Legislative Audit Division from state policy.

As mentioned earlier, there is a level of confusion with agency staff when it comes to differentiating between the different types of pay changes. This was apparent in the file review where audit work found 16 pay changes that were labeled incorrectly. During file review, if a pay change was mislabeled it meant that the supporting documentation could be based on the criteria for the incorrect type of pay change. This can lead to improper support of pay changes at the agency level. At a statewide level this generates concerns regarding the validity of pay change information in SABHRS. It was clear during interviews and survey responses that the number of pay changes available to agency staff during SABHRS entry is causing some of the confusion related to

data entry. In some cases state policy would refer to different state policy for further clarification on when to use a certain type of pay change. However, in many cases no further clarification was offered. There are also types of pay changes available in state policy that are not available in SABHRS. For example state policy offers results adjustments as a pay change option, but this is not an option in SABHRS. In other cases agencies would have types of pay change options in their pay plan that were not available in SABHRS. In these cases agency staff have to guess which pay change options in SABHRS best fits the situation. This leads to inconsistency and inaccuracies in entering pay changes.

The Department Needs to the Simplify Data Entry Options to Improve Consistency

Agency HR personnel should have clear choices in SABHRS to choose from. This means having a list of pay changes in SABHRS that does not include options so similar it is difficult to determine which type is appropriate. As part of our work, we noted other states have a more centralized process for determining what pay change type is appropriate, and if it meets central criteria for that type of pay change. The states we spoke with have centralized staff enter the pay changes, creating consistency without more specific criteria. For example, in South Dakota agencies fill out pay increase request forms, which are reviewed and entered by the State Bureau of Human Resources. One office entering all pay changes creates greater consistency in the system. In Montana, the decentralized system requires a succinct list of pay change options for agencies to choose from in SABHRS. The options in SABHRS should be unique from each other, making it easy for agency staff to determine which option is appropriate for the pay change situation they are dealing with. This will help improve consistency in how state agencies record pay changes in SABHRS as well as the accuracy of SABHRS statewide data on pay changes.

RECOMMENDATION #2

We recommend the Department of Administration condense and simplify pay change options available in the Statewide Accounting, Budgeting, and Human Resources System.

Chapter III – Pay Change and Pay Plan Review and Oversight

Introduction

Pay plans are currently created by agencies based on standards set in state policy, statute, and the broadband pay plan. These agency pay plans outline what pay change types are available to the agency, and how to properly support them. Biennially, agencies are required by statute to file their pay plans with the Department of Administration (DOA). DOA houses the documents from each agency as they are provided. As part of our audit work, we noted that DOA conducts a limited review of agency pay plans and notifies agencies if their pay plans do not cover pay change types they wish to use. This does not determine if their pay plans will lead to proper support of pay changes. Our work also identified that DOA does not periodically review state agency pay changes to ensure that they meet the requirements set in state law, policy, or agency policy. Pay changes are carried out internally by agencies based on pay plans that are created internally by agencies. This has led to inconsistency in the pay change support required by agency pay plans, and the support that is documented for those individual pay changes. In some cases it was unclear if agency staff were referencing their agency's pay plan during the pay change process. This chapter outlines the need for DOA to implement review processes for pay plans and pay changes in order to correct agency mistakes in the pay change process, and fulfill its statutory requirement to exercise leadership in personnel administration.

Individual Agency Pay Plans Are Inconsistently Implemented

The file review we conducted as part of audit work showed requirements to support pay changes in agency pay plans were not always met. In some cases human resource staff were not sure how some requirements of their pay plans could be documented. This indicates that agency pay change policy is not actively reviewed, nor being consistently referenced during the pay change process. This leads to inconsistent support for pay changes that do not meet the internal standards set by the agencies themselves. There is also inconsistency between agencies that comes from a lack of review process for their pay plans. Subject matter experts on pay change policy at DOA do not currently have a role in the creation of agency pay plan policy that forms the criteria for pay changes. This results in agency human resource staff taking sole responsibility for pay plan policy, even though in many situations they were not familiar with state level requirements for pay plans. DOA has provided agency staff with a guide to implementing pay plan rules, but it does not provide information on how to properly support pay changes.

During review of agency pay plans we found cases where parts of the plans were contrary, or not complete enough to meet state policy. For example, the Department of Transportation's (MDT) pay plan did not address a state policy requirement stating an individual receiving a temporary promotion had to be given notice describing why the promotion was given and its duration. As mentioned earlier, some agencies were also using types of pay changes that were not part of their pay plans.

Agency Pay Plans Do Not Align With Agency Pay Change Practices

In the survey conducted by audit staff of agency employees responsible for the pay change process across the state, over 20 percent of respondents indicated they had fewer pay change types in their agencies pay plan than actually used. This means these agencies are using pay change types without agency standards indicating when they should be used, or how they should be properly supported. In other cases, there were parts of agency pay plans the agency staff did not know existed. For example, the Arts Council has an employee incentive program as a type of pay change in its pay plan that agency staff were not aware of. According to the survey, over 30 percent of respondents indicated their agency pay plan had a greater number of pay change types than they use. In this case the agencies have parts of their pay plans that are not contributing to the agencies' mission because of lack of use. This also adds confusion to agency pay plans. It furthers what audit staff heard during interviews with agency human resource personnel that these are not living documents that are frequently referred to during the pay change process.

State Agencies Do Not Measure the Success of Individual Pay Plans

The Broadband Pay Plan Guide requires each agency to have a system in place for measuring and recording the success of its pay plan in achieving agency goals. Audit work did not find any agency that had a system set up for this measurement. This means that agencies are not making informed decisions regarding which parts of their pay plans are effective, and which need to changed. In most cases agency staff were unaware of what measuring their pay plan would look like, or how to begin measuring the activities of their pay plan. The Broadband Pay Plan Guide does not go into detail about what measures should be in place to properly determine if a pay plan was successful. A common idea from agency staff was to look at staff turnover. However, there can be many factors that determine turnover. If a meaningful measurement of pay plan success is going to be implemented by agencies, DOA needs to determine what that would include. DOA would also need to provide guidance to agencies on its implementation as part of a review process. Measurement of agency pay plans provides information on their effectiveness to the agencies themselves, as well as to the

legislature. This helps in the assessment of the effectiveness of the broadband pay plan as a whole, and the effectiveness of the pay change tools.

Other States Have a Stronger Review of Pay Plan Policy

Most states reviewed during audit work had a central pay plan, or a review and approval process for agency pay plans. This allowed them to verify that pay plans led to a consistent pay change process by ensuring that a base level of support was required for pay changes in each pay plan. For example, Idaho centrally approves all agency pay plans and sets up rules and criteria for all types of allowable pay changes. Wyoming, on the other hand, simply has a state compensation policy that outlines the types of pay changes agencies are allowed to use. Since each agency in Montana has its own pay plan, there needs to be a centralized review process to determine if pay plans meet state policy requirements. This will help to proactively change pay plans to conform with state policy. This review, combined with a clearer state policy regarding pay changes, will lead to more consistency across the state. This will allow DOA to discuss with agencies which pay change types will work best for each agency, and how to properly support those pay changes. This will also help establish a process at each agency to fulfill the state policy requirement of having a system in place to measure the success of its pay plan.

RECOMMENDATION #3

We recommend that the Department of Administration:

A. *Establish and implement a review process for agency pay plans based on state policy to determine if pay plans meet minimum requirements for pay change support, and*

B. *Assist agencies in establishing measurements for the success of their pay plans.*

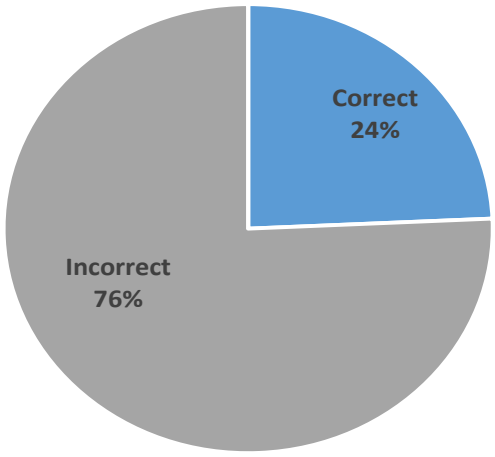
DOA Does Not Review State Agency Pay Changes

Pay changes are handled internally by agency staff. Aside from establishing statewide policy, DOA does not have a role in reviewing agency pay changes to ensure they are being implemented appropriately. It is up to each agency to determine if pay changes have been properly supported before awarding the pay change to an employee. We found that over 86 percent of the sample of pay changes reviewed were not supported. This included pay changes that had no documentation as to why the pay changes were given. For example, the State Auditor's Office gave a strategic adjustment without any documentation supporting why the pay change was given. There was only an email

from the supervisor stating the pay change was awarded. In this case the review by the agency did not determine that this pay change was improperly justified. There is no centralized review process to catch these types of scenarios, and prevent them from happening in the future.

During audit work we found that agency staff were not always clear on which pay changes should be used for certain situations. For example the Department of Fish, Wildlife and Parks (FWP) awarded a performance adjustment for an employee who had taken on supervisory responsibilities. This should have been a supervisory adjustment, but this mistake was not identified before it was entered by agency human resources staff. Without a centralized review process for pay changes, staff at the agency level are responsible for determining the appropriate type of pay change for the scenario. In order to determine agency staff's understanding of the pay change types, audit work included a survey of agency staff responsible for the pay change process at the agency. One set of survey questions asked agency staff to identify the correct pay change type that should be used based on a presented situation. Audit staff presented two scenarios in the survey. One scenario that would lead to a competency adjustment, and one that would lead to a situational adjustment. The combined results of these questions are presented in Figure 4.

Figure 4
Agency Staff Were Asked to Identify Pay Change Type by Scenario Presented



Source: Compiled by the Legislative Audit Division from survey data.

As illustrated by the figure, there is significant confusion among agency staff regarding which pay change type should be used in which situation. Agency staff were only able to identify the correct pay change type 24 percent of the time. Again, agency staff are the final check on pay changes, with no review process to determine if they are making the correct pay change type decisions. Using the wrong pay change type for the scenario will lead to improper documentation that does not correctly support why the pay change was given.

In addition to state agencies incorrectly selecting pay change types, we found that FWP and MDT were giving across-the-board market adjustments to employees. This is not prohibited under the broadband pay plan, but the procedure to carry these out

was not documented in the agencies' pay plans. For these two agencies in our sample, across-the-board market adjustments cost their agencies a total of $2.67 million for fiscal year 2015. These were pay changes that were given with a goal of getting everyone within the agency to a certain percentage of the market midpoint based on their position. This results in everyone in a position making the same base salary. While this is allowed under the broadband pay plan, it is a transition back to a pay scale system similar to what was in place prior to implementing the broadband pay plan. The broadband pay plan is designed to allow each agency to have a system in place to provide pay changes according to performance and other factors. This will naturally lead to differences in pay amongst individuals in the same position. In addition to the lack of clear guidance provided by DOA to state agencies regarding pay changes, the lack of a centralized review process has made the pay change process inconsistent. This has contributed to agencies turning to across-the-board adjustments that result in complete equity of pay in the various positions of the agency. While across-the-board market adjustments are not prohibited under the broadband pay plan, they take away the flexibility of the agencies to more actively manage employee through the pay change options in their pay plans. The broadband pay plan focuses on individuals receiving pay changes based on the agency's pay plan, which will lead to differences in pay between employees in the same position.

Pay Changes Have a Significant Cost to the State

As part of our audit work, we identified 173 out of our sample of 200 (86.5 percent) pay changes that were not properly supported by agencies. This led to a cost to the state of over $394,000 in fiscal year 2015. This generates questions about the $9.5 million in pay changes awarded in fiscal year 2015. Based on the information available, the pay changes in our sample did not meet the criteria established in agency pay plans, state policy, and collective bargaining agreements. Pay changes represent a large, ongoing expenditure for the state. They are awarded based on a process that is carried out internally in the agencies without oversight. A review of pay changes would help to provide some oversight of this cost to the state. This would help to ensure that agencies offer proper support for these ongoing personal service expenditures. This allows DOA to fulfill its role in statute to encourage and exercise leadership in the development of effective personnel administration.

Other States Provide Centralized Review of Agency Pay Changes

In other states reviewed, pay changes are entered into their payroll systems centrally. This allows for a second layer of approval by centralized HR staff who are experts on pay changes, and what support is needed to properly justify them. In this case there is a review by a third party who looks for the justification required, and is not

influenced by the person awarding or receiving the pay change. In South Dakota a proposed pay change is sent to the Bureau of Human Resources. Based on the information submitted by the agency, the Bureau of Human Resources determines if it meets the state criteria for the type of pay change that was submitted. In the Montana broadband system this decision making process happens within individual state agencies. In lieu of a centralized decision making process, a review process for pay changes by DOA would help to improve consistency in pay change documentation. DOA could review a sample of pay changes to determine if they met requirements in agency pay plans, state policy, and union collective bargaining agreement policy for proper support. DOA would not be making decisions on whether the pay change was warranted. It would ensure agency pay change decisions were supported. For example, if a performance adjustment was awarded by the agency, DOA would not be making judgments regarding whether the employee performance was good enough to warrant the adjustment. DOA would be looking to determine if the performance assessment and any other required support was provided.

DOA Provides A Review Process for Agency Reclassifications

Audit work noted that DOA conducts a review process for reclassifications. The agency annually takes a sample of reclassifications, either randomly or according to judgement if one looks suspicious, and review the documentation to determine if it is supported. The review of pay changes could be conducted in a similar way. This would help create consistency in the support of pay changes across state agencies. DOA could then explain to agency staff how their pay change support deviated from requirements in policy. This would help improve pay change processes at the agency by identifying and addressing practices that lead to improper support. Since these pay changes are being conducted outside of legislative control, this would provide a level of central oversight that does not currently exist while not impacting an individual agency's ability to provide pay changes as part of the state's broadband play plan. This would help to properly justify difference in pay, and ensure that broadband pay change options are being used according to the applicable policy. This would also improve accountability for the public funds used for these various pay changes.

RECOMMENDATION #4

We recommend the Department of Administration take a more active role in the pay change process, including developing and implementing an annual review process of pay changes to determine if they are properly supported based on agency policy, updated state policy, and union collective bargaining agreements.

Chapter IV – Statewide Pay Adjustment Analysis and Funding

Introduction

As part of the second objective, audit staff examined the distribution of pay adjustments across state agencies for fiscal year 2015. This review looked only at those pay change types that are described in state policy as pay adjustments. This focused the analysis on those types of pay changes that are completely at the discretion of the agency, which are defined as pay adjustments. Pay change types outside of pay adjustments such as promotions and reclassification are decided based on a hiring processes or job description, meaning that they are not completely at the discretion of the agency. This also excluded across-the-board pay adjustments given by the legislature. We evaluated the differences between state agencies regarding the distribution of pay adjustments among agency staff. We also looked for any factors that may impact a state agency's ability to provide pay adjustments such as overall agency funding sources, personal service funding sources, and types of positions receiving adjustments. Interview with agency staff indicated there were factors that influence the ability of an agency to provide pay adjustments, such as the main source of funding received by an agency. However, we determined there are no clear answers as to why some agencies are able to provide more adjustments than others.

Based on our review of pay changes presented in prior chapters, state agency staff currently apply and document pay changes inconsistently. This chapter discusses our analysis of the distribution of pay adjustments and what factors influence an agency's ability to provide pay adjustments. The across-the-board pay adjustments given by the legislature are one of the factors that can leave agencies without the discretionary funding necessary to carry out the broadband pay plan.

Statewide Pay Adjustment Data May Not Always Be Reliable

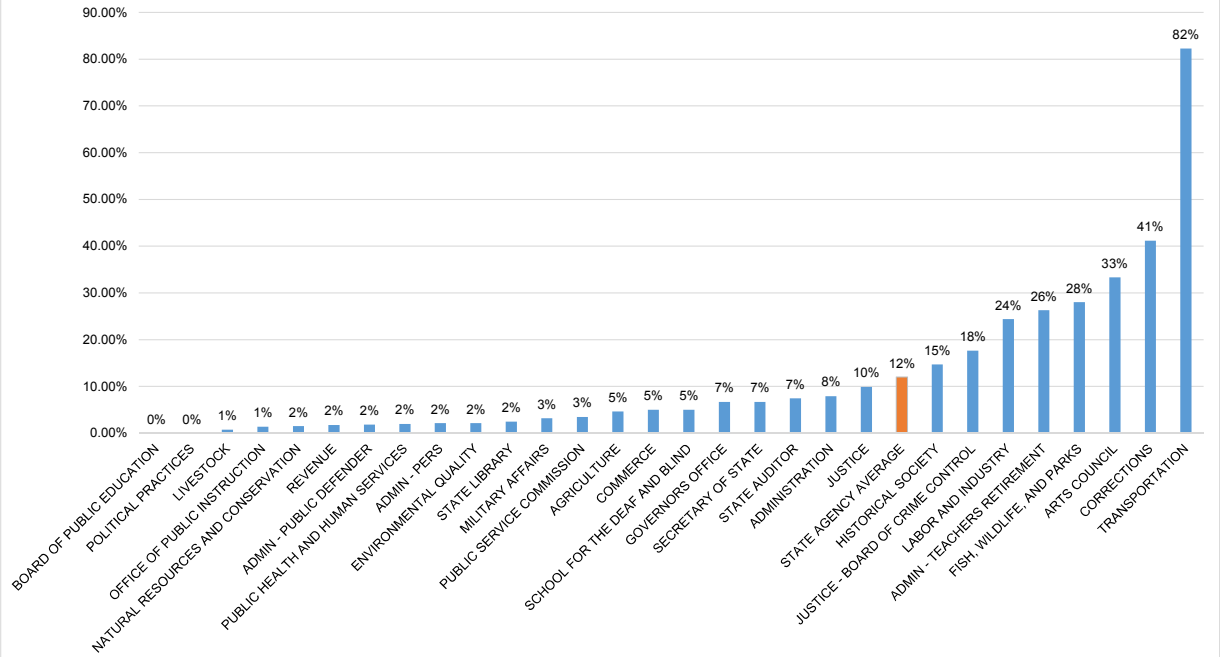
Audit work included a review of all pay adjustments across state agencies for fiscal year 2015. In order to conduct this analysis, we obtained statewide pay adjustment data from the Department of Administration (DOA) housed within State Accounting, Budgeting, and Human Resources System (SABHRS). SABHRS is the state's human resource and accounting system, which serves as a record of all state employee pay adjustments. Audit staff identified the number of employees under the broadband pay plan using this information. Audit staff then identified only those employees who received a pay adjustment as defined in state policy. This formed the base data that was analyzed to determine pay adjustment distribution statewide. Once this information was established, audit staff looked at the distribution based on various factors that can

impact the ability of a state agency to give employees pay adjustments. Audit work tried to identify any correlation between the pay adjustment data, and the different factors that could be broken down with the available data. This included looking at the adjustments by agency, job family, pay band, cost, and funding sources. Audit work also reviewed the costs of pay adjustments to the state. During audit work it became clear that there are issues with the SABHRS data that was used for the review of the distribution of pay adjustments. This comes from problems associated with the entry of pay adjustment data into SABHRS, as well as the inconsistent manner in which state agencies apply pay adjustments. With these issues in mind, the following represents the analysis of the fiscal year 2015 pay adjustment data.

Percentage of Employees Receiving Adjustments Varied Widely Between Agencies

The base analysis performed for this objective was determining which agencies were distributing the most pay adjustments. In order to compare across agencies while considering the number of employees in each agency, we looked at the percentage of employees receiving pay adjustments. Through this analysis it was clear that a handful of agencies have a significantly higher percentage of employees receiving adjustments. These agencies included Montana Department of Transportation (MDT), Department of Corrections (DOC), Department of Fish, Wildlife, and Parks (FWP), and Department of Labor and Industry (DLI). MDT was the highest with over 80 percent of its employees receiving pay adjustments. Twenty-one percent of all state employees under the broadband pay plan received adjustments in fiscal year 2015. Figure 5 (see page 27) shows the percentage of employees receiving pay adjustments for each of the agencies with employees on the broad band pay plan.

Figure 5
Percentage of Employees Receiving Discretionary Pay Adjustments
Fiscal Year 2015



Source: Compiled by the Legislative Audit Division from SABHRS data.

As illustrated by this figure, there are stark differences in the percentage of employees receiving adjustments at the various agencies, with the state agency average at 12 percent of employees receiving adjustments. The contrast between the agencies contributes to perceptions of inequity agency staff have regarding their ability to receive pay adjustments based on which agency they work for.

Agency Pay Plan Policy and Types of Adjustments Affect Percentage of Employees Receiving Adjustments

Agencies are free to choose which pay adjustment types they want to include in their pay plans. How they use the pay adjustment types they include in their pay plan differs between agencies. For some agencies, a higher percentage of employees receiving adjustments was the result of across-the-board pay changes that were given in order to bring everyone in the agency up to a certain salary based on the position. To do this, an agency creates a formula to get every employee to a certain percentage of an established market midpoint. The market midpoint is determined by annual salary analysis that DOA does, based on pay information from surrounding states. For some agencies, these adjustments were done without specific funding from the legislature. For example, MDT used carry forward funding and transferred money

from other budget categories to personal services to pay for these adjustments. In the case of MDT, these increased costs will be reflected as increased personal services costs in the agency's request to the 2017 Legislature. In some cases the legislature allocated funding to specific agencies for certain adjustments. For example, the Department of Justice and DOC received funding for specific adjustments. MDT, FWP, and DLI did not receive any specific adjustment funding. Other agency pay policies have systems in place for frequent pay adjustments based on performance or a career ladder. This will naturally lead to more pay adjustments for employees as they are carried out. DLI had a probationary period ending adjustment that was given when an employee made it through the probationary period. On the other side, agencies like the Department of Public Health and Human Services (DPHHS), Department of Revenue, and Department of Natural Resources and Conservation all have under 5 percent of their employees receiving adjustments.

State Employees Perceive Inequity in Agencies' Ability to Give Pay Adjustments

According to the survey of agency employees who are involved in the pay adjustment process, over 60 percent either agreed or strongly agreed that there is inequity in agencies' ability to offer pay adjustments. As part of our evaluation of statewide adjustment data, we discussed with agency staff the factors impacting the ability of state agencies to provide pay adjustments. For example, state agency staff frequently indicated that much of the ability of an agency to provide adjustments hinged on an agency's main funding source. Agency staff frequently perceived that agencies funded primary with federal resources as "rich agencies," providing them an increased ability to award pay adjustments. Conversely, state agency staff characterized agencies funded primarily with general fund appropriations as "poor agencies," with a limited ability to provide pay adjustments to employees. Regardless of the factors that lead to the wide variance in the percentage of employee receiving adjustments at an agency, this has led to the appearance of inequity between agencies. Agency employees questioned whether these perceived inequities should exist between agencies since they are all employed by the State of Montana.

Funding Source Does Not Clearly Indicate an Agency's Ability to Give Pay Adjustments

Agency staff frequently referred to funding source as a major factor in an agency being able to award pay adjustments to its employees. In order to determine if this correlation existed, a primary funding source for each agency as a whole, and the primary funding source for each agency's personal services were established. Primary funding source is defined as the largest funding source. We identified the primary funding source for

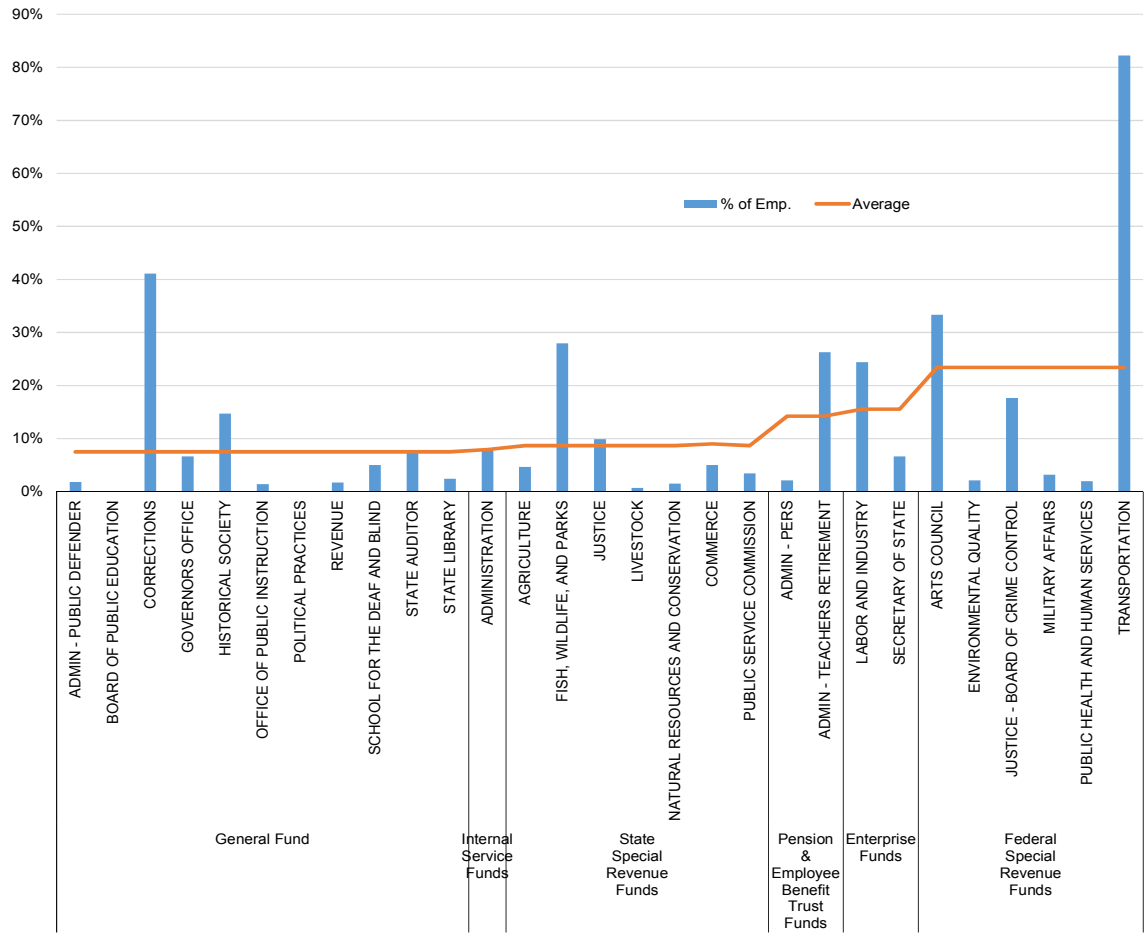
each agency, and then attributed the percentage of employees receiving adjustments from those agencies to the appropriate funding source.

The funding source with the highest percentage of employees receiving adjustments varied when looking at the primary funding source for the agency in general, versus the primary funding source for each agency's personal services. If funding source controlled an agency's ability to give pay changes, then all of the agencies with a certain primary funding source would have a high percentage of employees receiving adjustments, while agencies with other types of primary funding sources would have a lower percentage of employees receiving adjustments. However, audit work determined there were a variety of agencies with varying percentages of employees receiving adjustment for each funding source. For example, MDT and DPHHS both had a primary funding source of federal special revenue for the agency in general, but MDT had over 80 percent of its employees receiving pay adjustments, while DPHHS had only two percent of its employee receiving adjustments. Figure 6 (see page 30) shows that under each primary general funding source there are agencies with varying percentages of employees receiving adjustments. As illustrated by the figure, there is not a clear relationship between an agency's primary funding source and its ability to provide pay adjustments. This figure illustrates the percentage of employees receiving an adjustment in each agency, with the primary funding source for that agency listed at the bottom. The figure also has a line illustrating the average percentage of employees receiving adjustments for each of the primary agency funding sources.

Figure 6

Percentage of Employees Receiving Adjustment in Each Agency With Primary Agency Funding Type

Fiscal Year 2015



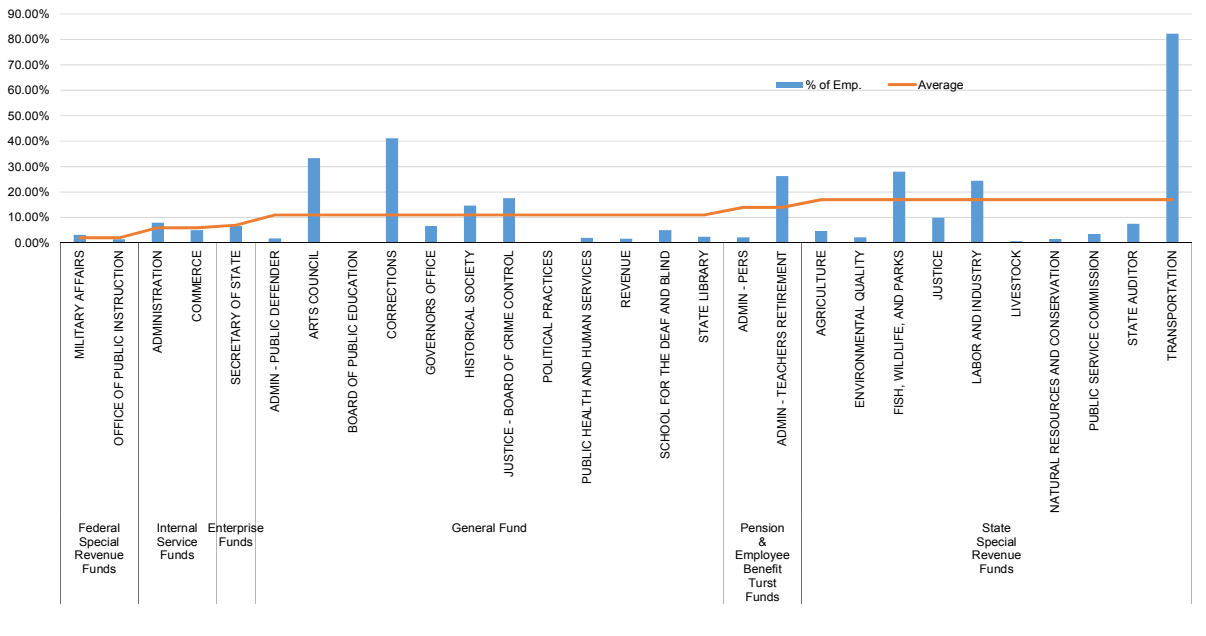
Source: Compiled by the Legislative Audit division from SABHRS data.

In looking at primary personal services funding source there were similar examples. The personal services funding source with the highest percentage of employees receiving adjustments was state special revenue. However, this category included agencies with varying percentages of employees receiving adjustments. This highlights that a certain primary personal services funding source also does not correlate with an ability to give adjustments. Figure 7 (see page 31) shows that primary personal services funding source also had little effect on an agencies' ability to give pay adjustments. This figure also illustrates the percentage of employees receiving an adjustment in each agency, with the primary funding source for each agencies personal services listed at the bottom. The figure also has a line illustrating the average percentage of employees receiving adjustments for each of the primary personal service funding sources.

Figure 7

Percentage of Employees Receiving Adjustments by Agency With Primary Personal Service Funding Type

Fiscal Year 2015



Source: Compiled by the Legislative Audit Division from SABHRS data.

As illustrated in the figures, the average percentage of employees receiving pay adjustments varied by funding source for both agency funding in general and personal services funding. We found that the funding source with the highest percentage of employees receiving adjustments was determined by which funding source MDT fell under. MDT had over 80 percent of its employees receiving adjustments. This raised the average percentage of adjustments for the funding type they fell under. MDT's primary funding source was federal special revenue for the agency as a whole and state special revenue for personal services. As seen in the figures, these were the funding sources with the highest average percentage of employees receiving adjustments because of MDT's high figure of 80 percent of employees receiving adjustments. Based on our analysis, funding source does not determine an agency's likelihood of giving a certain percentage of its employees pay adjustments.

Distribution of Pay Adjustments Across Employee Subsets Varied Widely

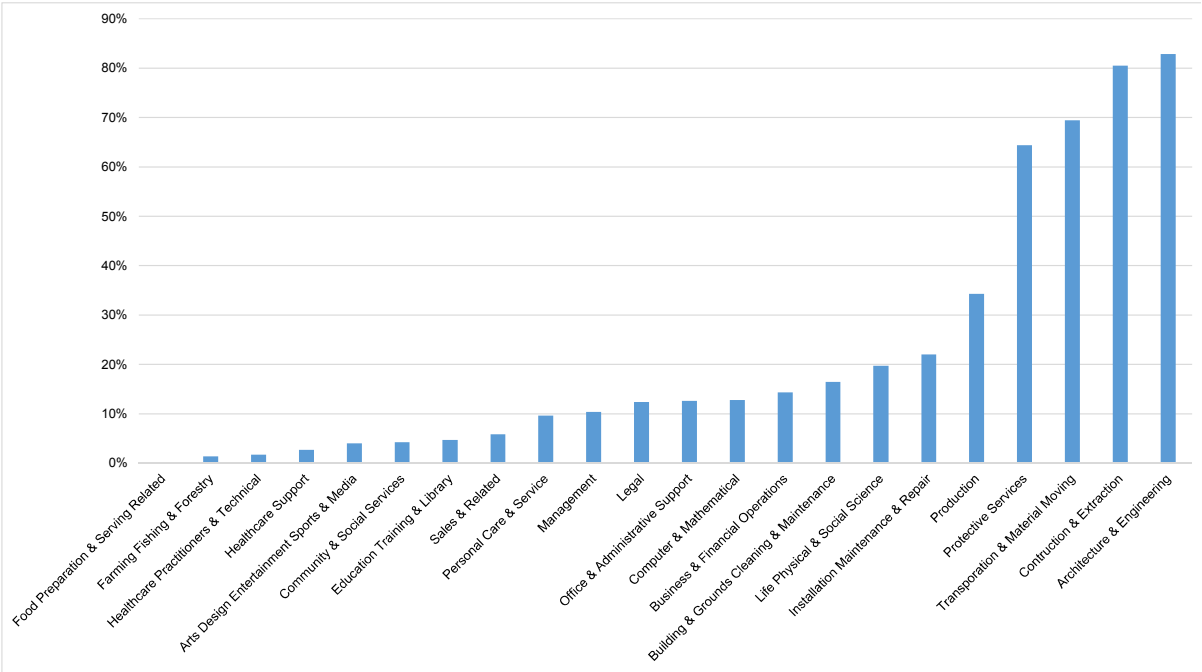
Positions in state government are broken into various subgroups within SABHRS. Audit work used these subgroups to determine if there was inequity between the percentages of employees within these groups that are receiving adjustments. This

does not point to the cause of the distribution of pay adjustments, but provides more information on their distribution. This information will show how they are distributed by job family and pay band. Job families are groups of similar positions based on the general types of tasks those positions perform. Pay bands refer to the nine pay bands that make up the broadband pay plan. These run from lower paying positions at band one to the highest paid positions in band nine. The following sections discuss the distribution of pay adjustments based on these groups.

Employees Receiving Adjustments Varied by Job Family

Positions in state government are grouped into job families based on standards from the federal government. This is a classification system to group similar positions by the types of activities performed by those positions. For example, the life physical and social sciences job family includes FWP wildlife biologists, foresters, and other similar positions. Looking at pay adjustment information by job family offers a look into which types of positions were receiving a greater percentage of pay adjustments. We found fields such as construction and extraction and architecture and engineering included a higher percentage of employees that received a pay adjustment. This was not surprising because these are all job fields with positions associated with MDT, which had 80 percent of its employees receiving an adjustment. Protective services, which is related to law enforcement, is another job field that also had a high percentage of employees receiving adjustments. This included positions such as game wardens. This job field had many positions at FWP and DOC, which were agencies with high levels of employees receiving adjustments. Figure 8 (see page 33) shows the percentages of employees receiving adjustments for each job family.

Figure 8
Percentage of Employees Receiving Pay Adjustments by Job Family
Fiscal Year 2015



Source: Compiled by the Legislative Audit Division from SABHRS data.

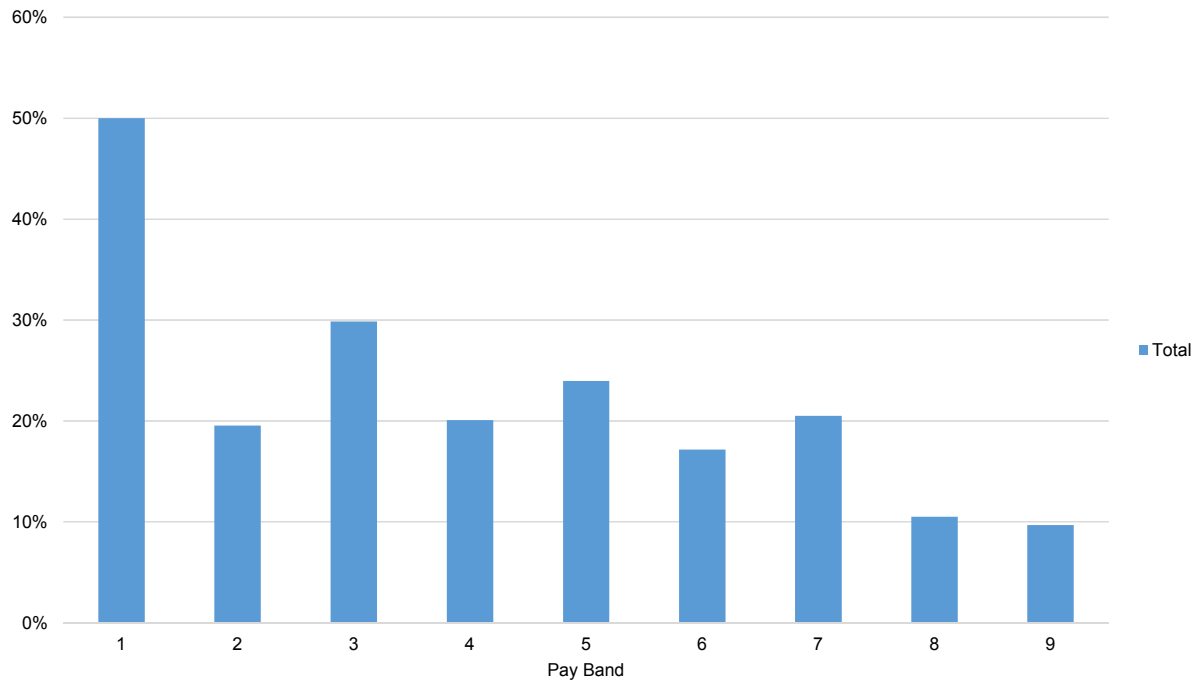
Based on state policy, there is no basis to suggest that the distribution represented by this figure is improper. There is a tendency for technical and highly skilled job families to have a higher percentage of employees receiving adjustments. However, these job families are predominantly made up of positions from agencies such as MDT that have a high percentage of employees receiving adjustments. The graph does show there are wide gaps between the different job families. This contributes to the perception of inequity among agency staff regarding their opportunity to receive pay adjustments.

Percentage of Employees Receiving Adjustments Varied by Pay Band

There are nine pay bands in the broadband system. All positions are assigned to one of the pay bands based on duties. Each pay band has a pay range, with the higher bands having higher pay ranges. Audit work included a review of the percentage of employees receiving adjustments for each pay band. Outside of pay band one (only had two employees with one receiving an adjustment) there were varying percentages across the pay bands. Pay bands two, four, and seven were almost identical at around 20 percent of employees receiving adjustments. Pay band three was the largest with 30 percent of employees receiving adjustments. Eight and nine were the lowest with

around 10 percent of employees receiving adjustments. Figure 9 illustrates how pay adjustments are distributed amongst each of the pay bands.

Figure 9
Percentage of Employees Receiving Pay Adjustments by Pay Band
Fiscal Year 2015



Source: Compiled by the Legislative Audit Division from SABHRS data.

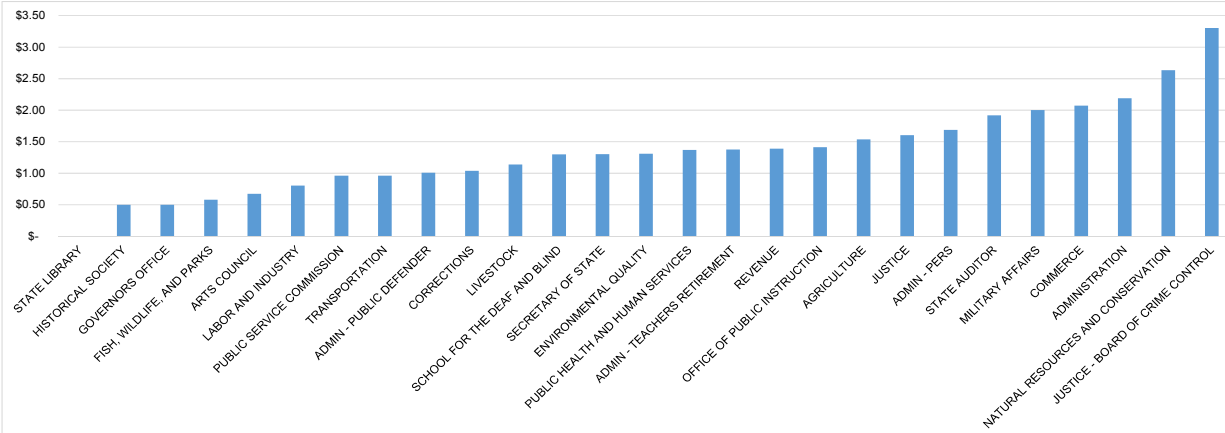
While there is no established criteria to indicate how pay adjustments should be disbursed between pay bands, this shows the percentage of employees receiving adjustments is similar between bands with the percentage of employees receiving adjustments generally trending lower for the higher the pay bands. This could come from the perception that pay in higher bands is higher, and does not need to be raised as frequently at the discretion of the agency.

Pay Adjustments Represent a Significant Cost for State Government

As part of our analysis of statewide pay adjustments, we examined the total costs of pay adjustments provided by state agencies in fiscal year 2015. MDT had the highest total cost for pay adjustments at over $2.4 million for fiscal year 2015. The cost of individual pay adjustments ranged from $0 to over $7 per hour. When looking at the average cost of pay adjustments for an agency it ranges from the Governor's Office at $.50 per hour to DOJ-Board of Crime Control at $3.30 per hour. Those agencies that gave

across the board market adjustments have relatively low average cost of adjustment, at under $1.00 per hour. The broadband pay plan is set up to allow agencies to award pay adjustments as they see necessary based on their pay plans. As part of the broadband pay plan there is no limit to the size or amount of pay adjustment that can be given. The following figure shows the average per hour pay adjustment cost falls within a range from $0 to $3.30 per hour. Our analysis also showed a general trend of agencies with more pay adjustments having a lower average cost per hour.

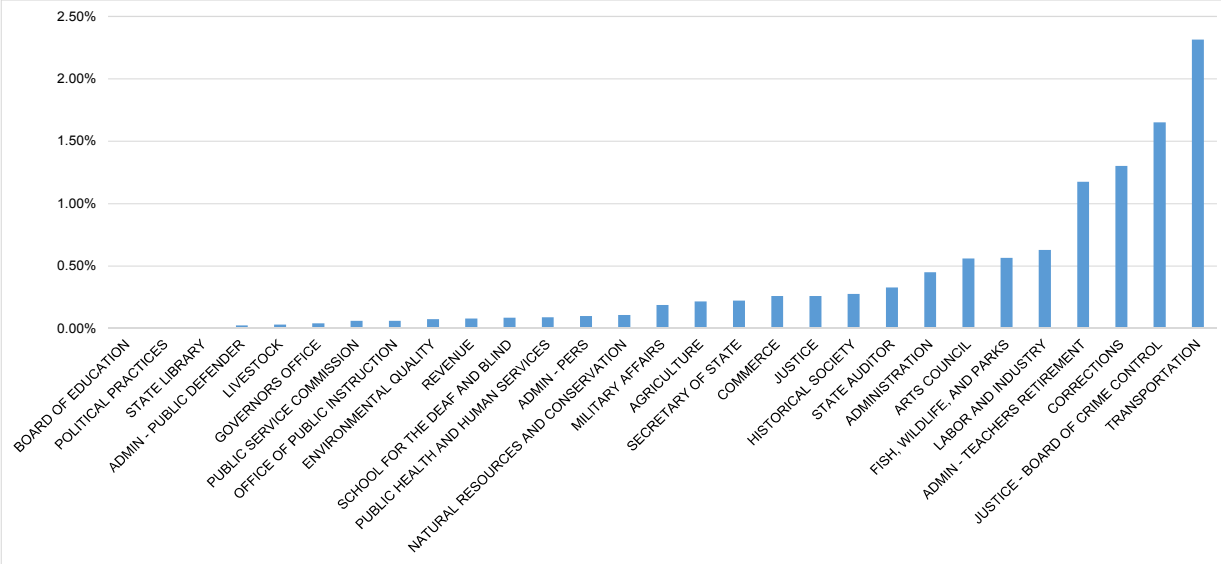
Figure 10
Average Pay Adjustment Cost Per Hour by Agency
Fiscal Year 2015



Source: Compiled by the Legislative Audit Division from SABHRS data.

Audit work also compared the average cost of adjustment with the primary general funding source and the primary personal service funding source. Once again there does not seem to be a direct correlation between the funding source and the average cost of adjustments. This means that it is unclear if the funding source has any effect on how large of a pay adjustment an agency is able to give. Instead it appears to rely on available funds of the agency, and agency managements comfort level in expanding personal service expenditures. Figure 11 (see page 36) shows the yearly pay adjustment costs for each agency as a percentage of their total personal services funding. This offered an objective look across agencies, and determined how large of a personal service increase each agency was incurring with the pay adjustments they gave in fiscal year 2015.

Figure 11
Pay Adjustment Costs as Percentage of Personal Funding
Fiscal Year 2015



Source: Compiled by the Legislative Audit Division from SABHRS data.

As indicated by the figure, there are some agencies that are increasing their personal service costs with pay adjustments more than others. This varies from some agencies that are at a fraction of a percentage, to MDT that has raised personal service costs by over 2 percent. This indicates varying willingness and ability of agencies to give pay adjustments that will impact personal service costs.

Pay Adjustment Analysis Provided to the Legislature Is Limited

The analysis in this chapter provides detail regarding the distribution of discretionary pay adjustments across state employees covered by the broadband plan. This includes the extent to which individual agencies are able to use discretionary pay adjustments to actively manage their employees as was intended with the creation of the broadband pay plan. This type of analysis is not currently provided to the legislature on an ongoing basis. DOA management indicated that they have not been asked to provide this information to anyone in the past, so they have not conducted this type of analysis. However, the legislature has regularly shown interest in the use of discretionary pay adjustments. Discretionary pay adjustments are a key part of the broadband pay plan that should be analyzed periodically in order for the legislature to have a complete picture of their impact on the broadband pay plan.

Pay Adjustment Analysis Would Provide Information on the Effects of the Pay Plan

Under current statute, DOA is required to investigate the operation and effect of the general provisions and the classification process of the broadband pay plan. However, state law does not currently require any investigation or reporting of employee compensation, including the use of discretionary pay adjustments. Pay adjustments affect agency operations and budgets, and are intended to support each agency's mission, goals, and objectives. Providing information to the legislature on how they are distributed is critical to the legislature understanding what effect discretionary pay adjustments are having, and what monetary impacts they will have on future budgets.

Without this information the legislature does not know the extent to which agencies are able to use existing funds to provide discretionary pay adjustments to their employees, outside of statutory pay adjustments. The legislature's requests for more information on this process indicates that there is interest regarding the use of discretionary pay adjustment by state agencies. There may also be some degree of confusion surrounding the validity or appropriateness of the tools agencies have available to them outside of statutory pay adjustments. As the above analysis shows, agencies have a varying ability or willingness to provide discretionary pay adjustments to their employees. The legislature should have this information when making decisions about the broadband pay plan.

Current law not requiring analysis for pay adjustments under the broadband pay plan has left the legislature without key information about effects of the broadband pay plan. This kind of analysis and information would be relevant as the legislature considers the effects of agency personal services budget requests, and the relationships between discretionary adjustments and statutory adjustments considered as part of the biennial state employee pay plan. DOA's understanding of the pay adjustment process leaves it uniquely suited to gather this statewide information. This will help to ensure that the broadband pay plan is achieving its intended results going forward.

RECOMMENDATION #5

We recommend legislation be enacted requiring the Department of Administration to:

A. *Conduct a biennial investigation of the operation and effect of the application of discretionary pay adjustments under the broadband pay plan, and*

B. *Report results of this analysis prior to the commencement of each regular legislative session.*

Legislative Pay Adjustments Contradict the Broadband Pay Plan

One of the main characteristics of a broadband pay plan is the greater latitude provided to agency management regarding the establishment of their pay plans. The majority of legislative funding for pay adjustments is currently given through across-the-board adjustments to all state employees, rather than through the broadband pay plan. This strategy typically gives equal pay adjustments to all state employees under the broadband pay plan, and takes away the discretion from agency management to distribute pay adjustments according to their agency pay plan.

Across-the-board adjustments are clearly permitted by statute. However, this leaves agencies to provide pay adjustments through other avenues, such as vacancy savings, or other means of funding. As the audit work in this chapter shows, funding pay adjustments in this way leaves agencies with a varying ability to use their pay plans. In many circumstances, it largely comes down to the availability of funds, and an agency's willingness to expand personal service costs going into the future. While discretionary pay adjustments are currently outlined in the broadband pay plan as a way for agencies to support their mission, goals, and objectives, they are primarily used to supplement the across-the-board statutory pay raises given by the legislature. Based on statute, it is unclear if this use of discretionary pay adjustments follows the legislature's intent when the broadband pay plan was implemented.

Pay Adjustments Funding Under the Broadband Pay Plan

In 2001 the legislature passed legislation to implement a broadband pay plan. One of the main features of the broadband pay plan is to give agencies the ability to manage their workforce and provide pay adjustments to advance the missions of their agencies. This was a policy decision by the legislature to move to a system that allowed agency discretion to tailor their pay plans to advance their agencies' missions. However, the legislature has continued to primarily fund pay adjustments as across the board in statute since implementing the broadband pay plan. These two statutory decisions by the legislature run contrary to each other. This creates confusion and inconsistency at the agency level regarding the purpose of the pay adjustment tools under the broadband pay plan.

The variation between agencies in the percentage of employees receiving pay adjustments highlights their confusion regarding how pay adjustments should be initiated. This leaves only some agencies actively managing their employees as intended under the broadband pay plan. These differences between agencies have in turn created confusion for the legislature regarding how and why certain agencies are giving pay adjustments

beyond the statutory across-the-board pay adjustments. Under the current system only some agencies are able to fully use their pay plans to support their missions, goals, and objectives.

Statute is Unclear About the Use of Statutory and Discretionary Pay Adjustments

The statute establishing the broadband pay plan speaks to across-the-board adjustments without specifically addressing the agencies' ability to use the discretionary pay adjustments in their pay plans. Statute does not prohibit discretionary pay adjustments under the broadband pay plan, across-the-board pay adjustments by the legislature, or a combination of both types of adjustments. However, the use of legislative adjustments within the context of the broadband pay plan has created confusion on multiple levels regarding the legislature's intentions for how the discretionary pay adjustment tools of the broadband pay plan should be used by agencies. Our work identified a need for the legislature to clarify the use of statutory and discretionary pay adjustments for state employees as part of the state's broadband pay plan. The legislature's role could involve consideration of changes in state law to define an appropriate balance between statutory and discretionary adjustments, or whether one approach to managing employee pay should be favored over another as a policy preference. This kind of clarification would provide predictability and transparency to a process which currently lacks both, and should help strengthen agencies' ability to meet their missions and the legislature's goal of designing credible and effective pay adjustment policies for state employees.

RECOMMENDATION #6

We recommend legislation be enacted to clarify state laws regarding the use of statutory and discretionary pay adjustments under the broadband pay plan.

Department of Administration

Department Response

MONTANA DEPARTMENT OF ADMINISTRATION

"the backbone of state government"

Director's Office

Steve Bullock, Governor • John Lewis, Director

January 27, 2017

Angus Maciver, Legislative Auditor
Legislative Audit Division
PO Box 201705
Helena, MT 59620

Dear Mr. Maciver:

Thank you for the opportunity to respond to the audit of the Oversight of Discretionary Pay Changes for State Employees. We appreciate the professionalism of Jeremy Verhasselt and Alyssa Sorenson during the course of this complex and time-consuming audit.

Our comments to the audit recommendations follow:

Recommendation #1 – We recommend the Department of Administration take an active role in the pay change process by:

A. *Developing and implementing additional policy to determine what pay change types are available to agencies,*
B. *Establishing minimum levels of documentation for support and justification of pay changes,*
C. *Developing and providing training to agency staff on proper pay change procedure, including how to properly support and implement pay changes based on updated state pay change policy.*

Department Response: Concur

The department conditionally concurs with this recommendation. The department will develop additional guidance documents, review possible policy changes, establish additional minimum requirements, and provide training to agencies. The department proposes to complete and implement this work by December 31, 2017.

Recommendation #2 – We recommend the Department of Administration condense and simplify pay change options available in the Statewide Accounting, Budgeting, and Human Resources system.

Department Response: Concur

The department recognized the issues with pay change options in SABHRS prior to the commencement of this performance audit and is currently reviewing changes to pay codes, titles, and definitions for SABHRS. The department plans to implement these changes by July 1, 2017.

Recommendation #3 – We recommend that the Department of Administration:

A. *Establish and implement a review process for agency pay plans based on state policy to determine if pay plans meet minimum requirements for pay change support*
B. *Assist agencies in establishing measurements for the success of their pay plans*

Department Response: Concur

The department concurs. The department will update and expand its review process to include more robust pay change requirements within agency pay plans and will update its policy to include agency pay plan review and approval by the department. The department needs to wait until after the legislative session to change policy to ensure any statutory changes are incorporated. The department proposes this action can be completed by October 1, 2017.

The department will assist agencies to identify and establish measurements that agencies may use to determine if their pay plans are successful. The department proposes that agencies be required to include these preliminary metrics in the agencies' pay plan rules when each agency submits its pay plan rules to the department for review and approval as established in policy. The department will assist agencies in completing and reviewing their pay plan rules by June 1, 2018.

Recommendation #4 – We recommend the Department of Administration take a more active role in the pay change process including developing and implementing an annual review process of pay changes to determine if they are properly supported based on agency policy, updated state policy, and union collective bargaining agreements.

Department Response: Concur

The department concurs with this recommendation and will begin to conduct annual audits after the changes recommended above are in place. We will begin planning for this audit after policy changes are completed and agency pay plan rules are final. We expect the first audit will be complete by July 2019.

Sincerely,

John Lewis, Director

cc: Anjenette Schafer, Administrator