Office of
LEGISLATIVE AUDITOR GENERAL
State of Utah

ILR 2003-D

JUNE 2003

Review of Tax Commission Employee Incentives and Performance Awards

We conducted a brief review of employee incentives and performance rewards because of Tax Commission employee productivity and accountability concerns. Surprisingly, we found that almost all employees (99 percent) of the Taxpayer Services Division (division) received performance or incentive compensation in the form of cash or administrative leave. This performance and incentive compensation presents two concerns which are discussed in our review:

1. It does not appear to be based on criteria of excelled performance.

2. It comes at a time of severe state budget shortfalls.

Performance awards are appropriate for employees, but they must be given based on superior performance. They should also be reduced during tight budget times.

Clearly, we believe that state incentive and performance awards, when administered correctly, are not only appropriate, but are essential for a healthy work environment. We agree that *select* state employees need and deserve work incentives, but such incentives should be significantly reduced in tight budget times and given with extreme care based upon outstanding or superior productivity. However, we believe this is not the case because the Tax Commission, particularly the Taxpayer Services Division, is giving incentive awards to such a large percentage of their employees.

In 2002, the Tax Commission either paid-out in cash or gave administrative leave to employees as incentives awards valuing about $369,564. This total consisted of $137,001 cash incentive awards paid to employees in calendar year 2002 and $232,563 in leave hour incentives (about 9,000 hours of administrative leave) given in fiscal year 2002. Likewise, we also found other state agencies giving costly incentives during current times of state budget shortage.

Incentive and Reward Programs Lack Control

The Tax Commission has given almost 75% of employees a cash award in the last two years.

Over the last two years (2001–2002), the Tax Commission as a whole has given almost 75 percent of their employees a cash award. In 2002, the Tax Commission's Taxpayer Services Division total was even higher, with 99 percent of all division employees receiving an incentive for cash and/or administrative leave. These figures suggest that the Tax Commission's incentive awards more closely resemble an automatic benefit given to most employees. In our opinion, for incentive and reward programs to be effective, they must be selective and must reward exceptional effort. We are particularly concerned with incentive/performance award management in the Taxpayer Services Division. We believe division management needs to review their incentive program, the Star Award Program, and the performance agreement program known as the Win/Win Performance Agreement.

Also, our concern is that the number of cash incentives seems excessive during times when budgets are significantly reduced and employment positions are being eliminated. Further, in an environment where positions have been eliminated and productivity is less than possible, it makes little sense to give the existing employees so many hours of administrative leave as an incentive.

Awarding Majority Does Not Promote Excellence

If incentive awards are not tied to superior employee performance, then "...management is reinforcing behavior that is mediocre."

Incentive awards are supposed to be tied to superior performance, but appear to be given too frequently and are based on weak standards. We found that division management is rewarding the majority of their employees with incentive awards, rather than giving them to a more select few. It is our opinion that many of these awards are not based on exemplary work efforts. Hence, these broadly given awards are not being used as a tool to promote excellence.

An experienced human resource director in one of Utah's larger state agencies stated the following,

> If management rewards employees based on exceptional behavior and the behavior is not exceptional, then management is reinforcing behavior that is mediocre.

The data shown in Figure 1 suggests that Tax Commission controls for incentive and performance rewards need to be reviewed because of the high number of employee recipients.

Figure 1. Cash Awards Given to Tax Commission Employees Are Widely Given. This figure only includes cash awards; it does not include administrative leave that was awarded to the employees in 2001 and 2002.

Year	Total Employees	Employees Awarded	Percent Awarded	Total Awards
2001	813	687	84%	$231,695
2002	798	514	64	137,001
Two-year Average	**806**	**601**	**75%**	**$184,348**

Figure 1 presents award and incentive data for the entire Tax Commission. However, because of some existing productivity problems of which we became aware, we more closely scrutinized the Taxpayer Services Division's programs, as presented in the following sections.

The division gives "Star Awards" to reward performance. While some awards appeared valid, many were given to employees who did not appear to achieve more than normal job expectations.

Division's Star Award Program Lacks Controls and Firm Criteria

According to the Tax Commission's Star Award Program policy, Star Awards can be given to employees who achieve more than their normal job expectations. We believe the division awards Star Awards in cases where individuals are not necessarily exceeding normal expectations. Employees are being awarded for questionable reasons that have little to do with job performance. Of further concern is that there are no apparent controls on how many awards a person can receive in a given year.

Figure 2 shows examples of justifications given for why individuals received the Star Award. We did find that there were some valid examples for earning an award but, for the most part, the reasons that were given seemed to be what any reasonable employee would do as part of his or her normal job.

One employee was given a Star Award for the simple task of filling the printer with paper.

Figure 2. Some Star Awards Given to Division Employees for 2001 and 2002 Seem Questionable. Employees were rewarded with either $40 or three hours of administrative leave.

Individual	Reason the Star Award was Given
A	For filling a printer with paper and monitoring the fax and print-out documents basket.
B	For assisting with the summer party.
C	Exceeding customer expectations by having a poster printed for use in the division.
D	Helping “cover the phones” during the Christmas party.
E	For spending valuable time without complaint, to score and help with the selection of the employee of the year.
F	For faxing a letter for me because I had to go to a meeting.
G	For excellent work in preparing and helping serve lunch for an employee’s retirement party.
H	For submitting the winning name for the “Name the Newsletter Contest.”
I	Being a positive force in Tax Payers Services. This [agent] has added a spirit of community and pleasantry. Also a fun holiday spirit for the division.

Star Awards are approved or denied by supervisors. But, surprisingly, the division director cannot deny an award.

For a person to receive an award, he or she can be nominated by another employee. The employee’s supervisor can then agree with the reason and sign the award, or the supervisor can deny the award. Surprisingly, the director of the division cannot deny the award if the supervisor agrees with the nomination even if the director thinks it is questionable. The director signs all awards.

A potential problem we found with the Star Award program is that it creates an opportunity for people to nominate their superiors, which may lead to favoritism. Also, another potential problem is that it also makes it possible for employees to nominate their fellow employees in hopes that the favor would be returned. Such incentives which help to build a positive workplace would be welcomed *if* the division director was able to approve or disprove such nominations. But, since the director doesn't, there seems to be no check on such potential favoritism.

We asked the director why he has not denied some of the more questionable awards. He responded that it was against policy to do so, even though he knows that some of them are being awarded for the wrong reasons, including the reasons we discussed. He feels helpless because he cannot, as a director, deny a Star Award.

The frequency of giving the Star Award has gone untracked by both the division and human resources at the Tax Commission.

Finally, we are concerned that the frequency of Star Award use has gone untracked. When we contacted the division director to find out how many awards were handed out, he said that the Tax Commission's Human Resources personnel track the totals. But when we talked to Human Resources they said the divisions keep track of their own numbers and were unable to get the totals we needed. In short, neither had any idea of how many of these awards were being granted until we compiled the records for our report.

Win/Win Contract Does Not Appear To Award Exceptional Performance

Similar concerns exist in another performance evaluation tool the division uses for its employees called the "Win/Win Contract." Every quarter an employee meets with his/her supervisor and they set goals for the following quarter that they both feel are attainable for the employee and the group. Unfortunately, administrative leave incentives authorized under the Win/Win Contract are:

- not the most appropriate career incentives,
- not related to "exceptional" effort,
- not directly related to work duties and
- could be excessive because the time is poorly tracked.

Incentives used as part of the "Win/Win Performance Agreement" also do not appear to be based on awarding only exceptional performance.

First, because the Win/Win is used as a performance appraisal, the more appropriate incentive for this should be a progression along a career ladder or step increases, rather than administrative leave. Employees should be motivated by career increases instead of administrative leave. Performance appraisals should be used for management to help them determine who should get a promotion or a step increase without having to give administrative leave as a reward to the employees.

Second, some division employees told us that the supervisor ends up determining the new goals without the employee's input. The employee is graded on a "Satisfactory/Fail" basis. If the employee receives a satisfactory rating, the supervisor can award up to eight hours of administrative leave. Our concern is that the term "satisfactory" does not imply exceptional work. In other words, a satisfactory rating does not mean that the employee is doing exceptional work; instead, it means that the employee is merely doing what was asked of him or her. The rating needs to be "exceptional" because it is the criteria of the policy they are using to reward someone with administrative leave.

Third, we found that the Win/Win awards are given for accomplishing goals which are not directly related to productivity and do not award exceptional performance. The criteria used for the Win/Win performance evaluation is based on the policy from the Tax Commission's Incentive Award Program which states:

> Exceptional performance that has a significant effect on the individual's immediate colleagues or their work effort, or cost savings of some benefit to the division/department.

We question whether the goals set and met are in the category of exceptional performance. Because almost everyone in the division is receiving administrative leave, it tends to make one believe that you do not have to do exceptional work in order to receive an award.

Fourth, management does not track time given under the Win/Win. Consequently, they have no idea how much time is being awarded. The Win/Win performance evaluation is administered every quarter so an employee can receive up to 32 hours of administrative leave per year. It is up to the supervisor to determine how much administrative leave is awarded.

In our opinion, the Tax Commission needs to review their incentive policies to ensure they are promoting desired goals.

In light of our findings, and the overall incentive/performance evaluation theories being utilized, the Tax Commission should reevaluate their policies and determine if they are promoting desired goals (such as increasing productivity). We question whether, if so many of the employees in the Taxpayer Services Division are receiving incentives and performance awards, if the awards are truly being given for work which goes above-and-beyond expected duties. This leads us to believe that employees may not be as productive as these awards lead management to believe. Again, the incentive rewards should be based on measurable factors that can be tracked and then rewarded if, in fact, the performance is exceptional.

Other State Agencies Are Also Giving Many Incentive Awards

The Tax Commission is not the only state agency giving many state employees incentive awards in bad budget years.

Of further concern is that the Tax Commission is not alone in giving many state employees incentive awards. A cursory examination of six other state agencies indicates that incentive awards totaling $915,755 were given in calendar year 2002. It does not appear that the state has an overall policy or statement encouraging the limitation of such awards during the current tight budget cycle. Because of this, we believe the Legislature may find it productive to have all cash and administrative incentive awards reviewed for recent budget years. We further believe that the Department of Human Resource Management should consider advising agencies to significantly limit incentive awards during the current budget crisis, until a state-wide policy can be developed which would govern incentive awards during budget crises.

Figure 3 shows that the Tax Commission is not the only agency giving out cash incentives:

Figure 3. Average Bonuses Received per Person in Calendar Years 2001 and 2002 for Seven Agencies. This does not include administrative leave that was awarded to the employees.

Department	Bonus Averages CY2001	Bonus Averages CY2002
A	$ 399	$ 341
B	620	463
C	977	1,152
D	750	1,008
E	500	523
F	233	236
Tax Commission	337	266

Another concerning issue is that, similar to the Tax Commission, many of the agencies seem to give cash incentives to the majority of the employees. Figure 4 gives the significant total dollar amounts of incentives that were given out by the six agencies and the Tax Commission during lean budget times in 2001 and 2002. It also shows the percentage of employees receiving incentive awards.

Five of the six agencies reviewed are giving over half their employees cash incentives in down fiscal times.

Figure 4. Percentages of Employees Receiving Cash Awards From Seven Different Agencies and Award Totals. The percentages were determined by dividing the total number of employees receiving the cash incentive by the total number of employees* within the agency.

	CY 2001		CY 2002	
Agency	**Percent**	**Total Awarded**	**Percent**	**Total Awarded**
A	98%	$ 293,043	99%	$ 241,551
B	22	247,466	17	145,596
C	100	41,043	100	50,690
D	69	149,347	79	213,855
E	59	75,090	53	68,022
F	64	64,570	59	59,040
Tax Commission	84	231,695	64	137,001
Total Awarded		**$1,102,256**		**$ 915,755**

* *To determine the total number of employees, a date was randomly selected for each year and a count was taken.*

Some incentives in other agencies seem excessive but may have adequate justification.

To expand on Figure 4, we show in APPENDIX A, a detailed frequency distribution of the cash incentives for "Agencies A–F" and the Tax Commission. Most incentives shown in this appendix, for the six agencies plus the Tax Commission, were given in amounts under $500 each. Our data shows that in 2002, there were 1,606 individuals in the seven agencies who received these cash incentives under $500. However, some incentives from APPENDIX A appear excessive. As we met with representatives from each of the six agencies to review the data, we discovered that there may be adequate justification for some of the larger incentive amounts and percentages. While the agencies generally concur with the data we present, the detailed incentive amounts have not been audited. It is likely that much of this data will be reviewed in a larger, state-wide audit of incentive and leave use in state agencies.

To conclude, as stated earlier, we agree that employees should be rewarded, but only *if* their performance is exceptional. However, with such high percentages of the employees receiving cash incentives at the Tax Commission and in the number of agencies we examined, as well as

Employees should be rewarded if performance is exceptional. But with so many being rewarded, it is unlikely all awards are so based.

some excessive amounts given, it is hard to believe that all these awards are truly being earned based on substantial criteria. This is of particular concern during troubling budget times for state government.

Recommendations

1. We recommend the Legislature consider a full audit of whether state agencies' use of cash and administrative leave incentives during recent lean budget years was appropriate.

2. We recommend the Tax Commission review the incentive and performance award programs, particularly within the Taxpayer Services Division. We strongly recommend that the review criteria include:

    - basing the incentives and rewards on exceptional performance of work-related duties,
    - limiting frequency of incentives and rewards,
    - giving the division director approval power, and
    - closely monitoring the fiscal impact of incentives and rewards, particularly during state budget scarcity.

3. We recommend the Department of Human Resource Management review the reasonableness and frequency of recently given employee incentives within state agencies.

4. We recommend the Department of Human Resource Management develop guidelines for appropriate use of cash and administrative leave incentives during lean budget years.

Appendix A
Distribution of Cash Incentives Given in Select State Agencies

This figure corresponds with the discussion regarding performance incentives on page 9.

Frequency Distribution Shows Cash Incentives Given in Select State Agencies. While the majority of cash incentives awarded in seven different agencies were under $500, several seem excessive.

Incentive Award	Tax Commission		Agency A		Agency B		Agency C		Agency D		Agency E		Agency F	
	2001	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**	**2001**	**2002**
$1-500	535	421	532	580	218	211	15	3	102	71	105	96	244	224
501-1,000	116	82	175	110	121	85	11	16	53	73	29	19	28	22
1,001-1,500	26	10	27	14	37	12	12	12	28	35	8	4	4	3
1,501-2,000	9	-	5	5	14	4	2	13	11	17	3	3	-	1
2,001-3,000	-	-	1	1	7	-	-	-	5	10	5	8	-	-
3,001-4,000	1	-	-	-	1	-	1	-	1	3	-	-	-	-
4,001-5,000	-	-	-	-	-	-	-	-	-	1	-	-	-	-
5,001-6,000	-	-	-	-	-	-	-	-	-	1	-	-	-	-
6,001-7,000	-	-	-	-	-	-	-	-	-	1	-	-	-	-
7,001-8,000	-	-	-	-	-	-	1	-	-	-	-	-	-	-
Totals	**687**	**513**	**740**	**710**	**398**	**312**	**42**	**44**	**200**	**212**	**150**	**130**	**276**	**250**
Percent of Employees Awarded	**84%**	**64%**	**98%**	**99%**	**22%**	**17%**	**100%**	**100%**	**69%**	**87%**	**59%**	**53%**	**64%**	**59%**

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Agency Responses

June 2, 2003

Wayne L. Welsh, CPA
Legislative Auditor General
130 State Capitol
Salt Lake City UT 84114-0151

Re: Review of Tax Commission Employee Incentives and Performance Awards

Dear Wayne:

Thank you for allowing us to review the draft Review of Tax Commission Employee Incentives and Performance Awards. We appreciate the dedication and professionalism of your staff.

We have reviewed your recommendations and are examining our current procedures relative to performance awards. Some recommendations are to the Department of Human Resource Management and we await their guidance on those issues.

Sincerely,

Rodney G. Marrelli
Executive Director

kd

June 5, 2003

Mr. Wayne Welsh, Auditor General
Office of the Legislative Auditor General
130 State Capitol
Salt Lake City, Utah 84114

Dear Mr. Welsh,

Thank you for the opportunity to respond to your office's Review of Incentive and Performance Awards (ILR 2003-D). We appreciate your review of this area of management and agree with your belief that state incentive and performance awards are essential for a healthy work environment. We also agree that during tight budget times, the state's scarce fiscal resources should be managed appropriately. It is with these shared beliefs that we submit this response.

EXECUTIVE SUMMARY

1- **Agency incentive award programs should be used responsibly and appropriately.**
The Department of Human Resource Management (DHRM) has rules in place regarding the proper use of incentive awards given to state employees. Additionally, DHRM has modified and "tightened up" its rules regarding appropriate use of incentive awards, which will become effective on July 1, 2003.

2- **There is currently a great need for fair incentive award programs within the State.**
The relationship between compensation and employee motivation is a complex issue. While it is true that employees feel glad to be employed in these difficult economic times, the compensation analysis should not and does not end there. As your office indicated in its report, "incentive awards, when administrated correctly, are not only appropriate, but essential for a healthy work environment." We whole-heartedly agree with your assessment. Further, nearly all of the current literature dealing with human resource compensation concurs with your opinion that incentive awards are vital to a well-functioning workplace. This is especially true when the average state employee's salary is 17% below the market.[1]

[1] Currently the state's actual average salaries are 17% below comparable jobs in the market. In the past, the argument has been raised that the state's benefits were greater than those in the private sector. While that is true, this increase in benefits is not great enough to bridge the gap. Currently, the state's actual benefits package is 4% greater than the markets. However, this is an inflated number due to the fact that the benefits calculation is derived as a percentage of the employee's actual salary. If state employee's salaries were adjusted upward 17% to bring them into line with the market, the state's benefit package would only be 1.36% above the private sector. Therefore, even adjusting the state's compensation package to include benefits, it still leaves the state employee's total compensation over 15% behind the market. Additionally, there is a one-year lag in the data because of survey timing. This gap will likely increase as state employees did not receive salary increases this year.

3- **<u>The appropriate use of incentive award programs serves as a cost savings to the state.</u>** In the last two years, DHRM and other state agencies have systematically left positions vacant as employees left. The remaining staff had to assimilate the "ghost work" left by the departing employees. Under normal circumstances, a productivity increase of up to 2.75 % or 50% of the savings from the eliminated position can be given to compensate employees for taking on additional duties of vacating employees. For example, DHRM gave a minimal across-the-board award of $230 as a small token reward since state budgets were such that productivity increases were not feasible.

<u>ANALYSIS</u>

<u>Agency incentive award programs should be used responsibly and appropriately</u>.

DHRM, as the state's human resource office serves a leadership role in developing rules governing the appropriate and proper use of incentive awards for state employees. DHRM's Administrative Code contains a rule covering the appropriate use of incentive awards. DHRM's 2002 rule indicated that cash incentive awards could be given to "employees or groups of employees who propose <u>workable cost saving measures</u> and <u>other worthy acts</u>."(emphasis added)

In reviewing the auditor's report, DHRM agrees that some of the awards given by agencies potentially exceeded the scope of DHRM's rule. Therefore, DHRM modified its 2003 rule regarding incentive awards to "tighten up" the scope of agencies incentive awards programs. The new DHRM rule regarding incentive awards will take effect on July 1, 2003. Specifically, the modified rules placed the following additional requirements on incentive award programs:

1) all state agency written incentive award policies must now be "<u>approved annually</u> by DHRM" (emphasis supplied);

2) cash incentive awards can only be granted for cost saving proposals for "efforts or accomplishments <u>beyond what is normally expected on the job</u> for a <u>unique event</u> or over a <u>sustained period of time</u>"(emphasis supplied); and

3) all cash incentive awards must be <u>documented</u> and <u>approved by the agency head or designee</u>. (emphasis added)

DHRM believes that this measure will help alleviate much of the Legislative Auditor's concerns. Specifically, the auditor's report recommends that DHRM review employee incentive awards within the state and that DHRM develop procedures for appropriate use of incentives during lean budget years.

<u>There is currently a great need for fair incentive award programs within the State.</u>

We understand and appreciate the Legislative Auditor's concerns regarding the use of incentive awards during "tight budget times." Further, we agree that the rules governing incentive awards needed to be adjusted to provide for the proper use of incentive awards. However, another school of thought and the current trend in human resource management theory suggest that it is in lean fiscal times that incentive award programs should remain in place. Below are some quotes from recent literature on the subject:

1) "[T]he key to long-term growth is to make decisions now that will lay the ground work in ensuring that the organization succeeds both now and once the economy recovers." Reward Management; The Hay Group; 2001

2) "[I]t's incumbent upon the employer, no matter what the economic times, to attract and retain competent employees, and the way to do that is to express your appreciation in whatever manner you're able to do so." The Prized Employee; Governing Magazine; May 2003

3) "Do not hastily alter your incentive and bonus programs. Just because the financial performance is below last year's levels … does not mean that the programs need altering. Short- and long-term programs may be working exactly the way they should be and perhaps should be left as\ originally designed." Reward Management; The Hay Group; 2001

4) "Many people are trimming budgets because of the recent economic downturn, but now it's more important than ever to keep your incentive programs in place. These programs help to motivate your employees to keep the company running smoothly." Recognition During Tough Times; Premiere News; January 2002

5) "The value of non-cash benefits often becomes heightened in a down economy because employees are more nervous about their own security and look for reinforcement that their employer is indeed committed to them." Reward Management; The Hay Group; 2001

6) "Recession, economic downturn – call it what you will – smart companies are realizing that although there may be efficiencies to be reaped from their employee-incentive programs, cutting back on these programs isn't simply bad new for employees – it could be bad for business as well." Recognition During Hard Times; Human Resource Executive; Oct. 15, 2001

Further, in a December 2002 report to Congressional Requesters (GAO-03-2), the United States General Accounting Office (GAO) indicated that the "effective use of flexibilities can assist agencies in managing their workforces." Some of the flexibilities the GAO discussed as being effective management tools were incentive awards, both monetary and non-monetary. In fact, employee incentives awards were one of the "most effective flexibilities" agencies could use in "acquiring, developing, and retaining high quality federal employees." DHRM believes that the same reasoning holds true with state employees.

According to this school of thought regarding the use of employee incentive awards, the current budgetary crisis is not the right time to cut back on incentive awards to state employees, rather, the appropriate remedy should be to ensure that a sound incentive award program is in place and effectively used. State employees have persevered through two consecutive years of no merit increases. This is certainly disheartening for most, if not all, state employees as is evidenced by the following representative sample of letters received by DHRM:

1) “I am writing this to request your help. . . .I have been a State employee for almost 13 years. Since almost the very beginning I have worked a part-time job to make ends meet. Currently my salary is $12.56/hour. This after almost 13 years. . . .I also work two part-time jobs because I cannot meet the financial demands placed on a family of four. . . .My wife also is required to work part-time outside of the house to help purchase needed items like clothing and school supplies for our children. . . .”

2) “I work two jobs to pay the bills. I put myself through college so I could make a better living. I have a Master’s degree. . . .I tell you all this so you will know that I am not, to quote one of the administrative executives, ‘too lazy to get a good education so I can make something of my life.’”

3) “I am a 33 year old father with a college education trying to raise a family on $12.57/hr!. . .Isn’t there something that can be done to compensate us? . . .I grew up in Utah and I love it here. I don’t want to have to leave the state just to earn more money. I do value other things besides the money: family, community, recreation, lifestyle, etc., etc. But these other things do not put ‘food on the table.’. . .I constantly hear from co-workers and know first-hand how we cannot keep up with the amount of work coming across our desks. . . .each year we hear more (and often see) down-sizing taking place. I am not merely asking for ‘more pay and less work,’ only to be fairly compensated. . .”

4) “As a loyal, dedicated state employee, I feel it is unfortunate that I have to write this letter to bring to light the effects of our eroding compensation package. . . .Even during times of minimal inflation we have fallen behind the rising cost of living. . . .State employees often feel powerless with the current process where the legislature, who know little of our contribution or needs, react at midnight on the last day of their session and we stand by helplessly, hoping for the best.”

5) “I feel compelled to tell you how profoundly and completely disappointed I am with the compensation system and the people who wield it. . . .The entire process is flawed, from the highly politicized, initial budget recommendations by the governor, to the capricious decisions by the legislature to bestow any leftovers to State employees at the last minute of their annual sessions.”

6) “I wanted to write as an ex-employee of the state of Utah. . . .In the eight plus years that I worked for the State, I generally received the typical one step pay increase. This was about 2.75% each time. It was tough to see friends of mine working for the private sector receiving 4, 5 or more percentage increases each year. . . .Why is the State willing to pay out money to have people trained or gain new skills but are not willing to pay them properly to keep them around? I know I would still be working for the State of Utah if they could come close to competing with the rest of the world. . . .Employees just wanted to be treated fairly.”

It is in this climate that DHRM is required to take the lead in protecting the most valuable resource in the state, its human resource. It is becoming increasingly difficult to attract quality employees. Further, while the rest of the economy is slow, the state has been able to retain its quality employees. However, if agencies are not committed to doing all that they can for their employees during the difficult times, those employees likely will not stay when the market turns around and opportunities present themselves with salaries 17% greater than state wages. One of the ways to show employees that their agency is committed to them, is by giving appropriate incentive awards during these lean times. By showing this type of commitment to our employees, we have a greater chance of receiving a reciprocal commitment from our employees in the future.

The appropriate use of incentive award programs serves as a cost savings to the state.

DHRM is the corporate level, policy making human resource office in state government. We recognize our obligation to develop and implement fiscally responsible programs that contribute to employee morale and retention. This is particularly important because annual funding fluctuations do not allow for a comprehensive, long-term compensation strategy. As the corporate level office, we understand the need for us to "walk the talk" and take a leadership role in developing and implementing creative and innovative reward systems, particularly during lean budget years. The appropriate use of incentive award programs can serve as a method of cost saving to the state in numerous ways. A few of the ways that DHRM incentive award programs can and have saved the state money are as follows:

1) Variable pay is the most fiscally responsible way to reward employees. Variable pay is defined as "direct compensation that does not become a permanent part of base pay/salary and which may vary in amount from period to period"[2]. The trend in industry is to rely more on variable pay, which does not permanently affect salary expenditures, and to link variable pay to the vision and mission of an organization. The incentive programs we have used at DHRM were meant to accomplish these objectives. Variable pay based on performance, as most of our incentives were, encourages excellence because it must be re-earned based on performance during the measurement period. It also allows the ability to manage costs during a period of uncertain revenues.

2) Incentives saved money over productivity increases. As previously stated in the Executive Summary, DHRM gave across-the-board awards to its employees in the amount of $230. This far outweighs the cost of the filling the positions left vacant by departing employees or the cost of granting productivity increases to employees for assuming the extra duties from departing employees.

3) Sick leave incentive saved money and increased productivity. DHRM instituted a sick leave incentive program several years ago as a long-term cost saving measure. Under this policy, employees who take no sick leave are paid a $50 incentive award for each quarter. If an employee does not take any sick leave in a year, they are paid an extra $50 incentive award. The maximum allowable per employee is $250 per year, which is substantially less than the cost of using even a portion of the sick leave earned. Attendance incentives have been used in industry for many years to boost productivity.

4) Tiered incentives were performance driven. DHRM has given tiered incentive awards to staff during the past two years. Distinctions were made on the basis of overall performance and productivity during the year. The tiered system was structured to promote excellence through rewarding top performers at the highest level. Therefore, granting incentive awards

[2] Variable Pay: How to Manage it Effectively; Society of Human Resource Managers, White Paper; April 200.

based on performance can achieve greater productivity within the state, when given for unique events or for a sustained, high achievement over a long period of time.

CONCLUSION

We at DHRM agree with the Legislative Auditor's report that some past incentive awards may have been unwarranted. Further we agree that sound incentive award programs are essential to the smooth operation of the workplace. These incentive award programs need to be crafted and managed well, especially in lean budget years. The temptation to immediately cut back on incentive awards in order to expand the state's budget should be carefully considered because in the long run it could possibly hinder the state's ability to recruit and retain its quality employees. Rather, developing and implementing appropriate incentive programs is what DHRM believes to be the correct answer.

To that end, DHRM has adopted new and "tighter" rules governing the granting of incentive awards by state agencies. DHRM did this because it believed it to be the right thing to do. Further, we support the Legislative Auditor Office's responsibility to monitor the fiscal impact of state programs. In that regards, DHRM believes that proper incentive award programs are sound fiscal programs and ultimately provide the state a cost-savings.

It is with these thoughts that we submit this response to the auditor's report. While we agree with the auditor's report which indicates that a more appropriate incentive for employees would be "a progression along a ladder or step increases," this is not practical or even feasible in the state's current budgetary condition. It is in these times when career progression is largely reduced, that incentive awards should become an integral part of an agency's total compensation strategy.

Sincerely,

Karen Suzuki-Okabe
Executive Director, DHRM

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