QUALITY IN SALARY ADMINISTRATION: A COMPENSATION EXERCISE

Introduction

Students in human resource management programs receive a great deal of training in the design of various salary compensation programs. However, comparatively little direction has been provided students as to the proper administration of the day to day or year to year administration of individual salaries under such programs and the attendant salary administration problems that often arise.

This salary administration exercise is intended to provide students with just such experience in conducting a fair and motivational salary system. This exercise will include both a discussion of salary administration theory and its application to common salary problems salary administrators will encounter in industry within the confines of a traditional compensation program (all cases are based on actual industry situations). Students should have had prior instruction in designing a conventional compensation program to include job evaluation, designing salary ranges, policy lines, external/internal competitiveness issues, etc.

Review of Salary Administration Theory

The basic philosophy of salary administration is to motivate, enhance perceptions of fairness by preventing or correcting salary inequities, and controlling compensation costs by not over paying for the value of individual employee contribution to firm performance. To that end, conventional salary administration as practiced in industry has a variety of principles and directives:

General Merit Raises Guidelines

- Where there is no change in a person's performance from one budget year to the next, then the person in question should under normal conditions receive the same % merit raise from one year to the next.

- When there is a performance increase from one performance level to another, then the person in question should normally receive a higher % merit raise in order to recognize and reward the increased contribution by the employee to the company. This % raise should be sustainable for the foreseeable future at the higher level of performance.

- Likewise when there is a performance drop from one performance level to another, then the person in question should normally receive a lower % merit raise in order reflect the lower contribution to the firm by the individual and to call attention to the drop in performance. This lower % raise should also be a sustainable amount for the foreseeable future.

- The % merit raise given to a particular employee should be sustainable (that is the same % given from year to year in relation to the range maximum or when there is no range maximum in relation to external competition based on a professionally conducted salary survey; this assumes no change in performance) for the foreseeable future (approximately five years).

- In those situations where the % merit raise contemplated is not sustainable for a given performance level, then the % merit raise must be reduced to a level that is sustainable for the given % merit raise. Situations that are not sustainable include those that take a person's salary to one that is at or above his or her performance band or classification maximum in the near term (usually less than five years).

- Merit raises are usually provided on an annual basis. However, many firms stagger the date of the merit raise based on performance. Top performers usually receive their raises the quickest (12 months or less) with average performers taking the longest to obtain their merit raise (usually 15-18 months). In is important to note that this latter practice allows firms to better sustain merit raises as in some years a person will receive no raise but due to the cost of living and competitive adjustments salary range bands will usually have been adjusted upward by so some %, thereby allowing additional room for a merit raise for a such an individual.

Salary Band Issues Guidelines

- From time to time certain individual salaries may be above their allowable salary range maximum. This often occurs due to several factors. First, a person's performance level will commonly decline for various reasons. As a result their corresponding performance maximum salary range band falls as well. Sometimes, supervision grants raises that bring a person's salary above its range maximum without the proper authorities noticing or preventing the action. At other times, the company's compensation scheme may be above competitive levels or the pay policy is changed to one that is lower than the previous policy. Consequently, a number of individual salaries will fall above their revised range maximums.

- Nevertheless, once a person's salary is above it's range maximum, it is normally frozen or "red circled" until the person's salary somehow falls below the range maximum. There are several ways this could occur. Management could choose to lower the individual's salary. However, this should not be done except in extreme circumstances due to the adverse affects on motivation and morale. Other viable options, depending upon the circumstances, which may help resolve the problem, are promotion, an increase in performance, or waiting until the range maximum rises above the person's salary due to cost of living and/or competitive adjustments.

- Salary bands/ranges are often adjusted on a periodic basis (usually annually). In order to hold the purchasing power of a given salary level constant salary bands must be adjusted upward or lower based on the annual change in the CPI. Salary bands/ranges may also be adjusted upward or downward based on the company's salary levels (policy line) as compared to relevant competitive salary levels.

Promotional Guidelines

- Promotions may be made to recognize experience and contribution in the current position by a promotion in the current job (sometimes called a step or recognition promotion). Promotions may also entail a physical move/promotion to some higher-level vacant position.

- Normally promotions are linked in some manner to current performance levels and a person's capacity to handle higher levels or responsibility. This is often affected by shortages in talent (in which case people are promoted faster than normal), by a surplus in personnel (in which case workers are promoted less often), compensation levels are lower than competition (in which case workers are promoted faster), or when compensation levels are above competitive levels (in which case promotions are often slowed).

- Absent the above exception individuals should be promoted at a rate to where they are at their highest level of potential (so as to obtain their best work at their highest level of ability) about ten years before normal retirement age. Rules of thumb based on performance levels at large firms during normal economic times are as follows:
  Average performance-about three promotions in a career- about one every 7-8 years
  Above average performance-about five promotions in a career- about one every 5-6 years
  Excellent performance-about eight promotions in a career-about once every 3-4 years
  Outstanding performance-unlimited but about once every 1-2 years.

- Promotional raises normally vary from zero to 5% per promotion level. Industry practice is to grant a 5% raise (to maximize motivation/recognition) unless it would mean raising an individual's salary so high in his or her salary band that normal merit raises would not be sustainable and/or they would be so small as not to motivate.

- Promotions should not be allowed for individuals experiencing a drop in performance.

- Above entry levels many firms require that performance be sustained for at least two years before being eligible for promotion.

- Related experience outside company service may be counted toward promotion on the same basis as company service. Related degrees above bachelor's may also be counted as experience on a year for year basis, with a master's counting no more than two year's related experience and a PhD. counting as no more than four year's experience.

Retirement Issues

- Those individuals nearing retirement should be brought to their highest level of potential and salary band at least three years before retirement. This is done for several reasons. One, to recognize their many years of dedication and commitment to the company. Two, many retirement plans base their benefits and pension calculations on employee salaries. Third, it should enhance retention levels since the remaining workforce observes that someone staying a career with the company is treated well.

Special Adjustments

Special adjustments are granted when normal salary treatment (merit and promotional raises will not rectify a particular salary problem). Normally, salary adjustments above 10% are not allowed except in extreme circumstances. When there is a rather large salary equity discrepancy, the individual involved may receive (up to 10%) special adjustments for several years before the problem is corrected. There are several common situations in which special adjustments are used to correct salary problems:

- For whatever reason, sometimes some employee salaries will be below the classification range minimum. In effect, the company is paying the person below the amount the company itself says the job is worth. In such cases the individual's salary should be raised to or above the classification range minimum not only for motivational reasons but for legal ones as well. It is important to note that in such cases the individual involved could receive a special adjustment in excess of 10%. Due to the seriousness of the problem, it is not spread over several years as previously discussed.

- In some situations, usually industry boom periods, external salaries rise at a rapid rate. As a result some employees (often-short service employees) are paid a lower salary than those paid new hires). This is an obvious inequity (salary compression) that must be corrected. If normal salary treatment does not correct the problem then a salary adjustment is warranted. The normal rule of thumb is to have current employees at least $100 a month above new hire or potential new hire salaries.

- Under other conditions, particularly in most firms with no set salary structure (as in this compensation case) salary administrators must closely monitor relevant salary surveys to ensue that their employee salaries stay in line with competition based on the company's pay policy. Hence salary adjustments may be necessary to bring an individual up to competitive levels.

- It is important to ensure internal equity as well. In general, a person with higher performance and/or experience (and education) should be making more than someone with lower performance and or experience.

Raise Communication

- When communicating raises to employees it is important to explain what portion of the total increase is merit, promotional, and/or adjustment. Otherwise, employees will usually assume they will continue to receive the same total % raise in the future (assuming no change in performance). When an equity adjustment as been included in the raise this could mistakenly result in a demotivated employees. For this reason, many companies actually grant equity adjustment at times other than when the merit raise is awarded. However, for case purpose they will all be awarded at the same time.

Exceptions to policy

- Exceptions to company compensation policy and guidelines may be allowed under extreme circumstances. However, these should be rather rare events and must be approved by the highest levels of company management.

IT TAKES A SHARP PENCIL

Montgomery Sharp Pencil Accountants Anonymous is a regional accounting firm that has offices in Troy, Mobile, Montgomery, Huntsville, Athens, Auburn, Decatur, and Dothan. It's headquarters is located in Montgomery, Alabama. Montgomery Pencil employees a total of 125 employees. It has been in business 30 years and over the last five years has experienced an annual growth rate 25% as compared to an industry average of only 10%.

Sharon Walls has just been transferred to the Troy division replacing Joe Cool (encouraged resignation), who had been the branch accounting manager. Sharon currently earns an annual salary of $75000 and the last raise that she received amounted to 15% of her salary. Sharon was given the job due to the company losing several major accounts in the area. In fact, in the year 2018 this division lost $50000. In recent years this division has been plagued by high turnover. HQ human resources was able to get the last top three performers who resigned to provide a confidential exit interview. These interviews revealed that three top employees who recently resigned did so because of poor/unfair management and below market compensation as their primary reasons for leaving (they would not provide any further details) Sharon has been in the job now for 8 months. During this time Sharon has not only recouped the lost business, she has also had time to reorganize the office to make it more efficient. This reorganization included laying off 7 marginal employees after the company's annual appraisal evaluation and making better use of relevant computer technology. Ms. Walls has been budgeted $36000 to allocate among her nine subordinates as pay raises (high level company management rarely grant proposals above the amounts allocated). This amount includes money for promotions and any equity adjustments that are needed to rectify any internal or external inequities that might exist (particularly in view of the evidence gained from the recent exit interviews). Cost of living for 2018 is expected to rise at an annual 2.0%. There have been some ugly grievances at this branch over pay raises in the past, so Sharon has been strictly advised to base all of her allocations on purely objective reasons. No increase recommendation will be granted without an appropriate justification.

Salary recommendation should show the total amount proposed and its % of the salary. Salary increases must be distinguished based on merit adjustments (coded M), promotional adjustments (coded P), increases for promotion may be up to 5%. Equity adjustments (coded A) while all equity adjustments must be justified (this includes any communications that you would also provide the employee when giving the increase) any equity adjustment over 10% must carry additional extraordinary justifications. Round salary adjustments for CL 20 and above to the nearest $100 and round salary adjustments for the levels below CL 20 to the nearest $50.

1 Name*	2 EEO Stat	3 Cur Sal	4 Last Inc%	5 Ratings	6 PT	7 Job Title	8 CL	9 Serv	10 Hi Ed	11 Exp	12 Personal Data in file
Paul	H	57500	4%, 2/15	AA 2018 NI 2017 NI 2016 E 2015	26 25 25 26	Sr Acct Adsv	25	29	MA Acct	41	Nearing Retirement, wife died six months ago. CPA
Crystal	W	77000	12% Mar-01	AA 2018 O 2017 O 2016 O 2015	27 30 30 30	Acct Advs	24	10	PHD Acct	27	Single, no child, engaged 4 mo ago, male clients Love her. CPA
Tonya	W	37000	NA Jun-01	AA 2018 NR NR NR	26	ACCT	22	1	BA Acct	7	Pro Union, 2 yrs related experience
Scott	W	34500	7% Apr-01	E 2018 E 2017 AA 2016 NA 2015	28 27 26	ACCT	22	4	BA Acct	9	Works the most overtime, 2 yrs related exp Working on MA-acct
Tim	B	48000	5% May-01	A 2018 A 2017 A 2016 A 2015	25	Sr ACCT	23	15	MA Acct	22	Has six dependents, None of his kids over 14 CPA
Stacy	W	36000	3% Jun-01	AA 2018 A 2017 AA 2016 A 2015	27 27 27 27	Admin & Comp Spec	24	16	MA Eng	18	Loyal, hard working Not an acct, saves $ With programming skills
Rodney	W	39000	5% Feb-01	O 2018 AA 2017 AA 2016 AA 2015	29 25 25 25	Sr Acct	23	17	MA Acct	24	Working on PHD part time, clients like to Work with him and think he is top notch CPA
Max	B	15400	3% Jun-01	E 2018 E 2017 E 2016 E 2015	18 18 18 18	Acct Clk	15	5	NA	7	Married hard worker 4 yrs related exp
Warren	W	17600	1% May-01	AA 2018 AA 2017 NA	21 21 21	Sr Acct Clerk	16	2	BA Hist	8	Not out going, but very precise; never makes an error; work volume could be better 7 yr related exp

* columns reading left to right-column 1-employee name; column 2-Equal Employment Opportunity Status: W=white, B=black, H=Hispanic; column 3-current salary; column 4-% and date of last merit increase; column 5-perforamnce rating last four years: O=outstanding, E=excellent, AA=above average, A=average, NI=needs improvement, I=inadequate; column 6-highest level person is seen attaining in the firm or potential (PT); column 7-current job title, column 8-numerial job classification (CL), column 9-company service, column 10-highest level of education attained, acct=accounting, eng=English, hist=history; column 11-number of years of experience since age 18 (Exp plus 18 gives one a person's age), and column 12-additional information about the person.

Best Relevant Salary Data:

2019 Regional Accounting Salary Survey

Salary Accountants All companies By experience	Avg	Top Qtl	Salary Accountants Big Six Firms By Experience Avg
New Hire	35200	39600	39500
2-4 YRS	40000	46200	48000
5-9 YRS	31300	49500	56000
10-15 YRS	52000	55000	68000
16-20 YRS	59400	62500	75000
20 + YRS	66000	70000	88000
% Raise Given	6.5	7.5	8.0

2019 Administrative Assistants
Salary Survey

	Avg	Top Qtl
5-10 yr	23000	25000
11-15 yr	26000	29000
16-20 yr	29000	35000
20 + yr	30000	38000

2019 Computer Specialists (degreed)
Salary Survey

	Avg	Top Qtl
1-3 yr	50000	60000
4-6 yr	65000	80000
7-10 yr	85000	95000
11-15 yr	100000	110000
Over 15	120000	130000

2019 Accounting Clerk Salary
Survey Troy

Salary all Companies	Avg	Avg top 3 Co.
Accounting Clerk	15400	17600
Senior Acct Clerk	17000	24000

The first issue that students must address in this exercise is to decide on the maximum amount of a merit raise for each performance level and the timing of each raise. For the sake of simplicity raises in the case should be awarded on a 12-month basis. As can be seen from a review of last year's salary merit increases there is no consistency across individuals with the same performance in terms of merit raises. Based on judgment, experience, budget limitations, accounting for inflation, and some attempt to be consistent with previous year the following merit guide is a good starting point (instructor may want to provide this to the students):

MAXIMUM MERIT RAISE GUIDE

O - Outstanding	12%
E - Excellent	9
AA- Above Average	7
A - Average	5
NI - Needs Improvement	0
I - Inadequate	0

A pay policy must be chosen as well. This is not a major accounting firm, however, it is a rising regional star. A good choice in this case would be to choose a pay policy that puts accountants at or near the top quartile of all companies and below but not too far below the average (within 5-7 %) for the big six firms.


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