Leaders at the Core of Better Communities

Challenges in Executive Compensation: Getting it Right
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Overview

The spotlight is on public sector compensation, especially for executives, as local governments work to close the gap between essential services and available resources. In any environment, maintaining public trust around compensation is critical. ICMA's Compensation Guidelines establish a best practice for establishing and negotiating compensation for executives and staff. This session will explore the roadmap for managers and elected officials to set fair and reasonable compensation in a transparent process. The latest trends in local government executive compensation will be reviewed as well.

Preliminary Results from ICMA Compensation Survey 2011

ICMA launched the *ICMA Compensation Survey for Local Government Chief Appointed Officials* in an effort to be the source for reliable data on salary, benefits, and standard practices for local government executives. With increased focus on local government spending and recent controversies around public sector compensation, it's critical for ICMA to be able to respond to media inquiries and members needs.

The survey was sent to over 7,000 cities, counties and towns that have a Chief Appointed Officer (CAO) position. Statistically speaking, we had a strong response rate of 36%.

Data from the pool of 2,556 survey responses highlights the unique landscape of local government. While there are similarities in the work done by local government executives, compensation is influenced tremendously by the size and scope of responsibilities, portfolio of services, and geographical location. There is additional data analysis and perhaps even collection that needs to take place before a comprehensive set of results can be shared. That said, there is some interesting and valuable data to share.

Base Salary

The wide range of base salaries found in most states illustrates how simple observations – such as "average" salary – are of limited value. For example, the "average" salary for the sample is $108,722; however, there is a range of over $272,000 from the low salaries (in the $20,000s) to the high salaries (in the upper $200,000s).

Base Manager Salaries	
Mean Salary	$108,722
Median Salary	$101,000
Range High to Low	$272,500
Bottom 20%	Less than $72,000
Top 20%	Over $141,000
Over $200,000	4%
All amounts have been rounded.	

Only 4% of respondents report base pay of over $200,000. Of these, 56% are in California. Texas and Florida respectively came in next with managers who had base pay exceeding $200,000. In 38 states there was no one who reported base pay over $200,000.

To understand the complexity better, ICMA examined the detailed results from just four states: Arizona, California, Iowa, and North Carolina. All are strong council-manager states and provide some diverse geographic representation.

Base Manager Salaries: Arizona, California, Iowa & North Carolina				
	Arizona	**California**	**Iowa**	**North Carolina**
Mean Salary	$132,000	$183,000	$86,000	$105,000
Median Salary	125,000	$186,000	84,000	$94,250
Range High to Low	$161,000	$247,000	168,000	$184,000
Bottom 20%	Under $90,000	Under $145,000	Under $60,000	Under $72,000
Top 20%	Over $131,000	Over $222,000	Over $108,000	Over $131,000
Over $200,000	5%	37%	0	3%
All amounts have been rounded.				

The Negotiation Process: Who leads? Who decides?

- **Lead in Negotiating Manager's Compensation:** Forty six percent state that the elected officials take the lead in negotiating the manager's compensation. Only 30% use a council compensation committee mirroring the standard practice of the private sector and non-profits. The new ICMA guidelines on compensation recommend use of a council compensation committee.

- **Approval of the Manager's Compensation:** It's not surprising that 95% of respondents report that the governing approves the manager's compensation. Formal approval via an employment agreement or vote of the governing body should be utilized for all benefits the manager may take. This step provides transparency for the public and security for the individual.

Employment Agreement/Contract

Formal employment agreements outlining the terms, conditions and benefits of employment are the norm. **Eighty four percent** of respondents note that they have either an agreement or contract formally approved by the governing body.

- **Employment Agreement Fixed Term:** A majority of employment agreements do not have a fixed term (54%). Those that do, have contracts with an average length of 33 months. Only 17% of those in this fixed term arrangement are entitled to be compensated for the entire value of the agreement if terminated before the end.
- **Lead in Contract Negotiation:** Who leads the negotiation is a bit unclear from the survey as over 50% checked "other" when offered the options of the local government attorney (18%), HR (3%), and compensation committee of the council (27%).

Severance Benefits

- Seventy-seven percent of respondents report that they are eligible for severance pay. Most commonly, severance is paid when termination is triggered by the employer. Interestingly, 20% of the managers responding who work in larger organizations (250,000-499,999) reported being able to collect severance if they left voluntarily.
- Eighty percent of managers have fixed not sliding scale severance pay. The average is 28 weeks of severance pay.

Performance and Salary Review

- **Annual Performance Evaluations are the norm:** Seventy-eight percent report that they receive an annual performance evaluation.
- **Salary Is Tied to Performance:** Sixty-two percent report that their salary is tied to performance.
    - **Merit Increase:** Fifty-two percent of respondents report eligibility for a merit increase.

  - **Bonus:** Only 25% of respondents see the reward for performance in the form of a bonus.
- **Annual Cost-of-Living Increase:** Forty-one percent of respondents report an annual cost-of-living increase (COLA). Only one-third has the COLA stipulated in the employment agreement. Most of those who do get a COLA are included in the across-the- board approach for all staff.

Benefits

- **Retirement Benefits:** Two retirement benefits are most prevalent—a defined benefit plan (60% report) and deferred compensation (47% report).

Retirement benefits	Percent reporting
Defined benefit plan	60%
Deferred comp (IRS Section 457 Plan)	47%
Pre-tax defined contribution plan	22%
IRS Section 401(k) Plan	8%
Savings Plan IRS Section 401(a) Plan	6%
Defined contribution plan maximum matched percentage	5%
Post-tax defined contribution plan	3%
SERP (Supplemental Executive Retirement Plan)	0%

- **Cash Out/Selling of Unused Vacation:** Forty-four percent of respondents, most working in communities over 50,000 in population, are able to sell or cash out unused vacation. Only a small number of respondents answered the question about the value of the transaction. The average value of the benefit was $7,920.
- **Cash Out/Selling Unused Sick Leave:** A much smaller percentage (25%) report being able to buy back unused sick leave than report being able to buy back vacation. The average amount is $5,592 ranging in value from $218 to $75,000. Selling unused sick leave at departure is available to 42% of the respondents but typically it's a benefit granted to all employees in the organization.
- **Executive Leave:** Only 20% of respondents, mostly from California, report receiving executive leave. The average amount of leave was 10 days. Executive leave was rarely added to the leave that could be cashed out.
- **Annual and Sick Leave:** The average public sector executive gets 22 days of annual leave and 14 days of sick leave.
- **Other Benefits:** Prevalence of some standard benefit options are indicated below.

Other benefits	% reporting
Life insurance	81%
Professional association memberships	70%
Car expenses/allowance	60%
Technology allowance (cell phone, computer, etc.)	44%
Long-term disability insurance	41%
Professional development expense allocation	37%
Short-term disability insurance	34%
Supplemental/excess long-term disability insurance	21%
Moving expenses	21%
Educational expenses	19%
Social club memberships	16%
Excess life insurance	10%
Housing assistance in the form of loans	1%
Housing assistance in the form of down-payment assistance	1%

Trends from 2002 to 2011: Compare results from ICMA's Survey on the Profession in 2002 to today's Compensation Survey results

Benefit	Percent reporting in 2002	Percent reporting in 2011
Cap on CAO salary	16%	15%
Compensation for job-related meetings outside of the regular workday	5%	4%
Eligible to receive severance pay	69%	77%
Average maximum weeks of severance pay	25	28
Average days of annual leave per year	18	22
Average days of sick leave per year	15	14
Car allowance	87%	60%
Cell phone (Cell phone and PC were separate questions in 2002)		44%

	79%	
Personal computer	81%	
Life insurance	90%	81%
Housing assistance	4%	1%
Life insurance	90%	81%

Future Research

Much work remains to fully understand the range of compensation practices in local governments. Base salary is only one component of compensation.   Areas where additional research is required include the following:

- Leave and the ability “cash out” leave annually or at separation/retirement;
- Retirement benefits;
- Periodic Pay Raises;

Data collected in this year’s survey will help refine the methodology for future studies, which will continue to be challenging at a national level given the range of different practices among states.

The results of this year’s survey lead ICMA to reaffirm its compensation guidance issued approximately one year ago. It is ICMA’s position that a manager’s salary should be based on salaries in the economic market within which the manager works and relative to the complexity and expectations of each local government. ICMA’s research can provide broad benchmarks and general guidance as starting reference points to the salary research required by an individual local government. This is the same type of research required for other employees in both the public and private sectors.

Challenges in Negotiating Executive Compensation

The lack of established practices for negotiating public sector executive compensation combined with the transparency threshold that must be met makes an otherwise difficult task almost daunting. Roles and responsibilities may be clear on paper but not in action. The decision makers, i.e. the governing body, are not always experienced with the process. The beneficiary, i.e. the manager, often is the more knowledgeable and skilled party.   The result can be compensation packages or benefits negotiated in good faith that later appear to be inappropriate, unfair, and/or just too costly.

Consider these real world challenges:

- The ICMA Model Employment Agreement recommends 1 year severance. The average length of severance is 6 months. Is negotiating a 2 year severance appropriate? If so, under what circumstance?
- Having negotiated severance, is it ok to negotiate and accept more in a forced departure? If so, under what circumstance?
- Post election and before a new majority is seated on the governing body, is it ok for the manager to ask for "sweeteners" to the employment agreement? Is it ok to accept them if offered by the council?
- A manager within retirement range wants to negotiate an exception to city policy that caps the amount of sick and vacation leave that can be sold back during employment. The manager will receive pay for all accrued leave upon departure but if approved now, this will result in a significant increase to the manager's pension benefit.
- In an effort to reduce payroll expenses, the manager proposes an earlier retirement incentive. Can the manager participate in the program? If so, when should disclosure of intent be made?
- A finalist earned significantly more in his prior position than the range advertised for the position. Is the finalist free to negotiate beyond the salary range?

ICMA Compensation Guidelines

Maintaining public trust and integrity in local government requires both effective governance and management of the organization. The following guidelines are intended to establish a best practice for establishing and negotiating compensation for local government executives and staff and to clarify the roles and responsibilities of the governing body, local government manager, and employee.

The Principles

Compensation and personnel matters should be guided by the core principles of the ICMA Code of Ethics. ICMA affirms that the standard practice for establishing the compensation of local government managers be fair, reasonable, transparent, and based on comparable public salaries nationally and regionally. ICMA members should act with integrity in all personal and professional matters in order to merit the trust of elected officials, the public and employees. Local government managers have an ethical responsibility to be clear about what is being requested and to avoid excessive compensation.

Elected officials perform a critical governance role providing oversight of the management of the organization. To that end, they must be engaged in establishing the process for determining and compensation for all executives appointed by the governing body.

Compensation should be based on the position requirements, the complexity of the job reflected in the composition of the organization and community, the leadership needed, labor market conditions, cost of living in the community, and the organization's ability to pay.

The Process for Negotiating Executive Compensation

To establish fair and reasonable compensation, the governing body should either operate as a committee of the whole or designate an evaluation and compensation subcommittee, to design and implement the methodology for setting the compensation of the local government manager and any other appointees of the governing body.

Compensation benchmarks should be established based on comparable local government and/or public sector agencies.

The governing body should engage experts whether contracted or in house as necessary to provide the information required to establish fair and reasonable compensation levels.

All decisions on compensation and benefits must be made by the entire governing body in a public meeting.

Compensation Guidelines for Local Government Executives

A starting point for the elected officials and local government manager in any salary negotiation should be to:

1. Determine the requirements of the job and the experience needed to successfully perform the job duties.
2. Examine market conditions to learn what comparable public sector executives earn. A best practice would be to gather information using pre-determined comparable benchmark local governments or public sector agencies.
3. Understand the services provided by the local government along with the nature of the current issues in the organization and in the community, and then compare these with the individual's expertise and proven ability to resolve those issues.
4. Identify the local government's current financial position, its ability to pay, and the existing policies toward compensation relative to market conditions.

In addition:

5. The individual's credentials, experience and expertise may be used as factors to set salary.
6. In areas where cost of living is high and the governing body wants the manager to reside within the community, salary negotiations may take into account additional compensation. In addition, other unique and special circumstances may be taken into consideration, such as difficult recruitment markets and the particularly challenging needs of the public agency.
7. During periods prior to the beginning of employment when terms and conditions are being negotiated and finalized, each party should also seek legal advice as needed and appropriate.

Severance

Severance provisions established in the employment agreement must be both reasonable and affordable so that the cost of the severance is not an impediment to fulfilling the governing body's right to terminate a manager's service, if desired. The ICMA Model Employment agreement recommends a one year severance but recognizes that the length of service with an organization may justify a higher severance.

Compensation changes

1. Benefits and salary increases should be reasonably comparable to those that local government executives receive within the designated benchmark or regional market area and generally consistent with other employees.
2. Merit adjustments or bonuses should be contingent upon performance and the overall financial position of the local government to afford additional compensation payments. Provisions regarding consideration of periodic merit adjustments in salary should be pre-determined.
3. Local government managers must recognize and effectively manage conflicts of interest inherent in compensation changes. Managers should avoid taking steps regarding pension and other benefits where they will be the sole or primary beneficiary of the change. Examples include:

    - Dramatically increasing salary thereby leading to pension spiking.
    - Recommending or implementing single highest year to determine retirement benefits.

4. An individual should receive a single salary that recognizes all duties and responsibilities assigned rather than different salaries for different assignments.
5. Local government managers should not put their personal compensation interests before the good of the overall organization and that of the citizens.

Transparency

1. Local government managers should provide their total compensation package to the governing body when requesting compensation changes so that the governing body has a comprehensive view of the compensation package.
2. In the interest of fairness and transparency, there should be full disclosure to the governing body, prior to formal consideration and approval, of the potential cost of any benefit changes negotiated during employment.
3. When the terms and conditions of employment are being renegotiated with the employer and at the end when the employment is being terminated, ICMA members have a duty to advise the elected officials to seek legal advice.
4. In the interests of transparency, the salary plan and salary ranges for local government positions, including that of the manager, should be publicly accessible on the agency's website.

General Compensation Guidelines for all Employees

1. Each local government should establish benchmark agencies which are determined using set criteria, such as, but not limited to:

   - Close geographic proximity
   - Similarity with regard to the nature of the services provided
   - Similarity in employer size/population size
   - Similarity in the socio-economic makeup of the population
   - Other similar employers in the immediate area

2. The local government should develop appropriate compensation levels that are in line with their labor market. Doing so will enable the organization to establish and maintain a reputation as a competitive, fair, and equitable employer as well as a good steward of public funds.
3. When considering any salary or benefit changes, the immediate and anticipated long-term financial resources of the organization always should be taken into account.
4. Appropriate financial practices should be followed to both disclose and properly fund any related future liability to the local government.

Next Steps

ICMA will complete the scrubbing and analysis of the current survey data; collect compensation data for executives in comparable public sector and NGO for benchmarking purposes; and continue annually to collect compensation data on city and county CAO's. The ICMA Model Employment Agreement is under review by a member task force. A revised version, incorporating the compensation guidelines and guidance on negotiating compensation, will be available by the end of 2012.

Takeaways

- A compensation committee of the governing body should be created to design and implement the framework for setting the manager's compensation.
- Compensation must be benchmarked to comparable local government and/or public sector agencies.
- Engage experts whether contracted or in house as necessary to provide information.
- Decisions on compensation and benefits must be made by the entire governing body in a public meeting.
- Managers should refrain from proposing changes to pension and other benefits where they will be the sole or primary beneficiary of the change.
- Greed is not good.

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