



Paul M. Shafer | Principal, Compensation Leader—Eastern U.S. AON Hewitt
Michael McAnally | Deputy Director, Office of Human Resources—City of Philadelphia
Andrea Wachob Kaelin | Director, Compensation—Main Line Health System

PEBA: Compensation in the Non-Profit World



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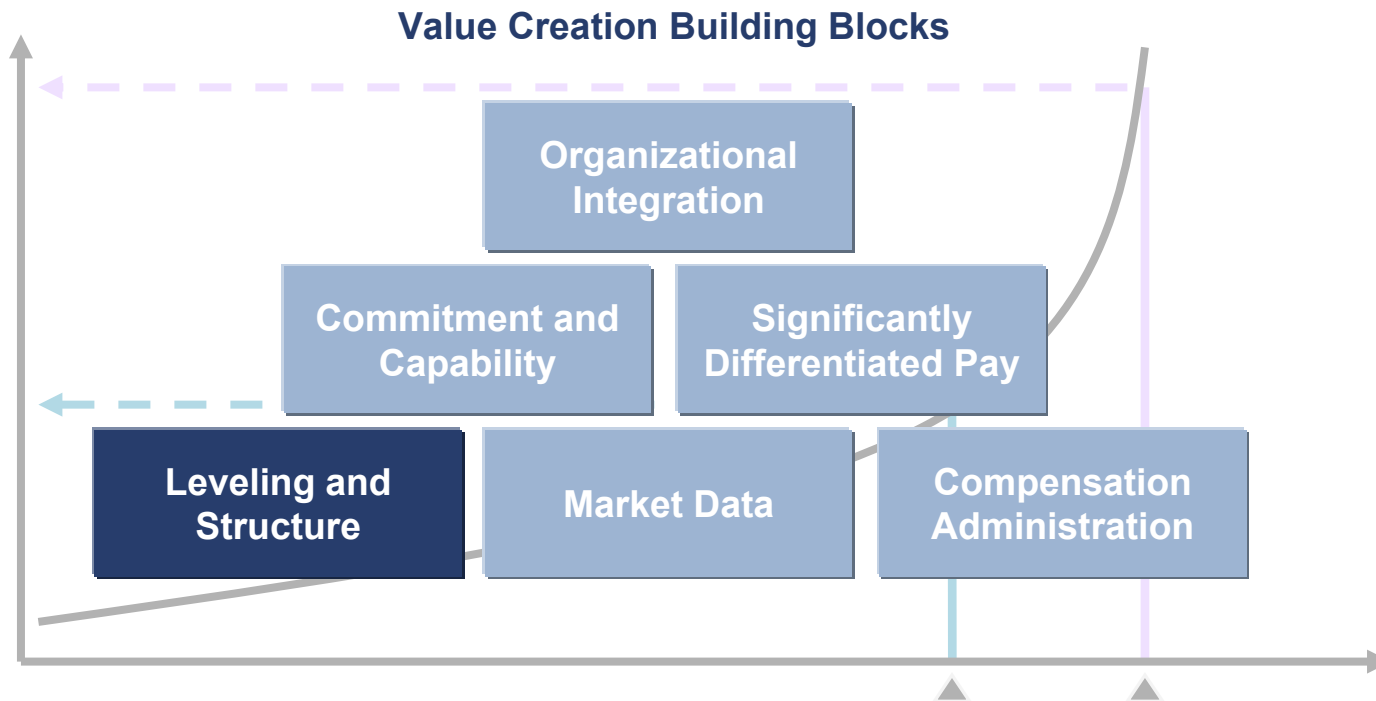
Agenda

- The Growing Total Reward Focus
 - Foundational Aspects of Pay
 - Total Reward Framework
- Trends in Salary Increases
- Trends in Broad-Based Variable Pay
- Executive Pay Spotlight
 - Executive Pay Climate
 - Short-Term Incentives
 - Long-Term Incentives
 - TBOR 2



The Growing Total Reward Focus: Foundational Aspects of Pay

Foundational Aspects of Pay



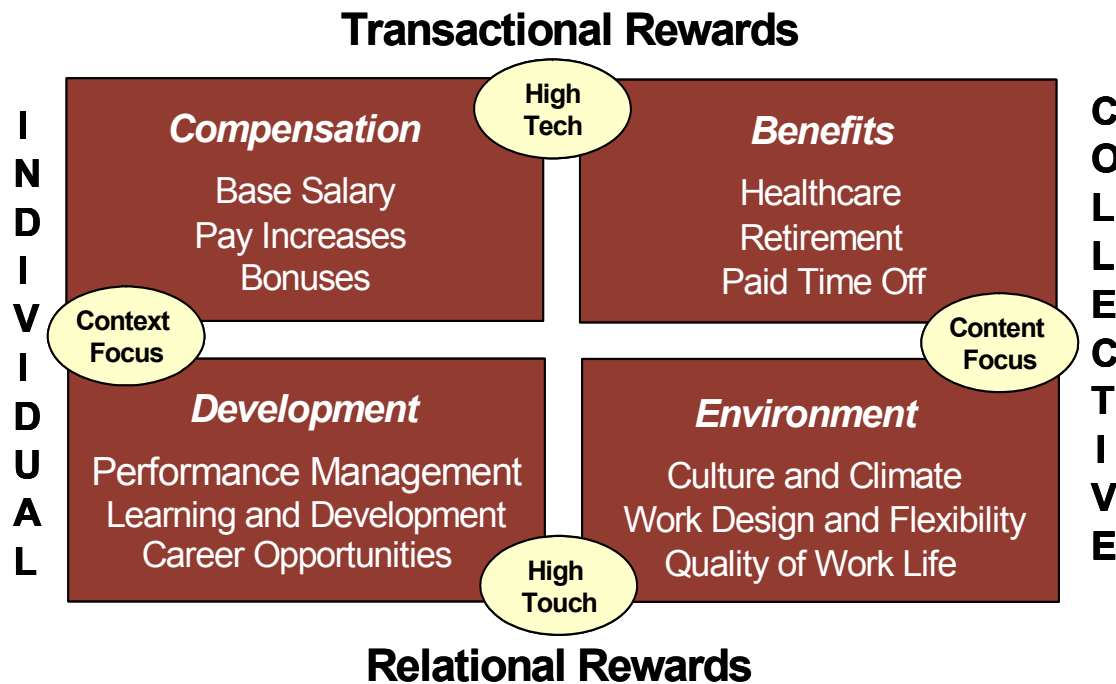
Foundational Aspects of Pay

- ERP Systems (PeopleSoft, SAP) require valid data in order to provide useful information
- Talent pressures will increase as the pendulum swings from a strong “internal” focus to greater balance between internal/external factors
- Staff are more aware and savvy regarding pay issues
- Deterioration of historically “great” benefits puts greater pressure on cash compensation
- The pressure to manage costs will remain, if not get stronger

The Growing Total Reward Focus: Total Reward Framework

The Growing Total Reward Focus

Hewitt's Total Reward Framework:

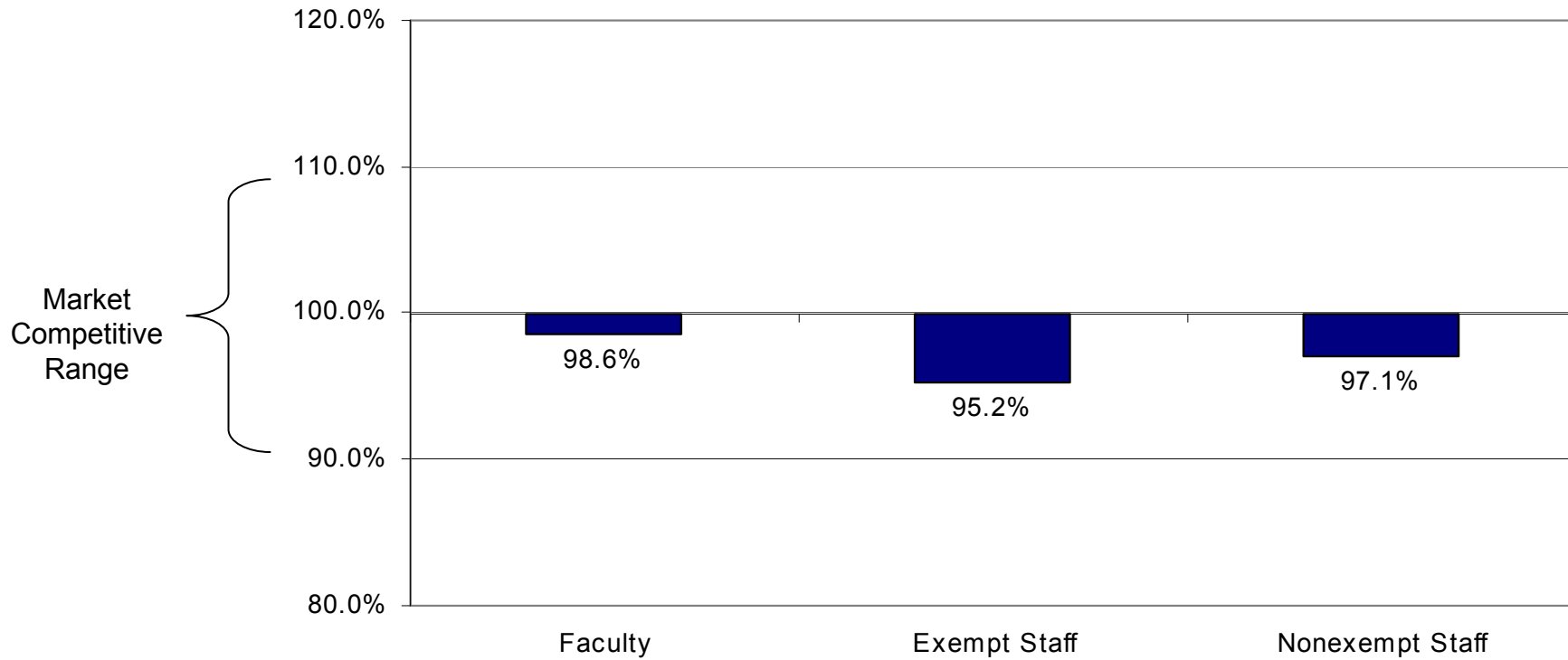


The Growing Total Reward Focus

- Need to emphasize the total value of the reward package, including the intangibles...***in light of pressures to contain/reduce rising benefits costs***
- Staff are more conscious of market pay levels due to changing talent mix, availability of market data, and publicity around executive pay
- Increased messaging regarding pay-for-performance increases staff attention on the pay program, especially cash component

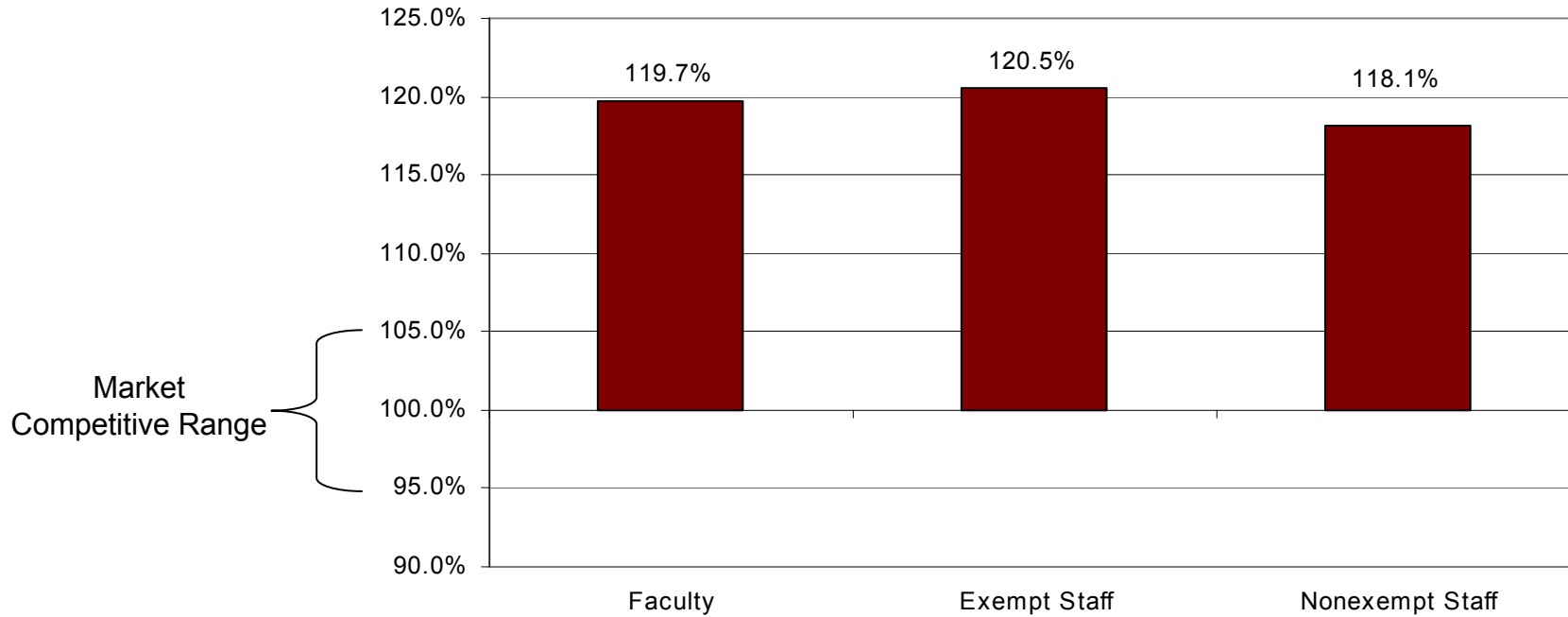
The Growing Total Reward Focus: One Example

Overall Base Salary Comparison to Market



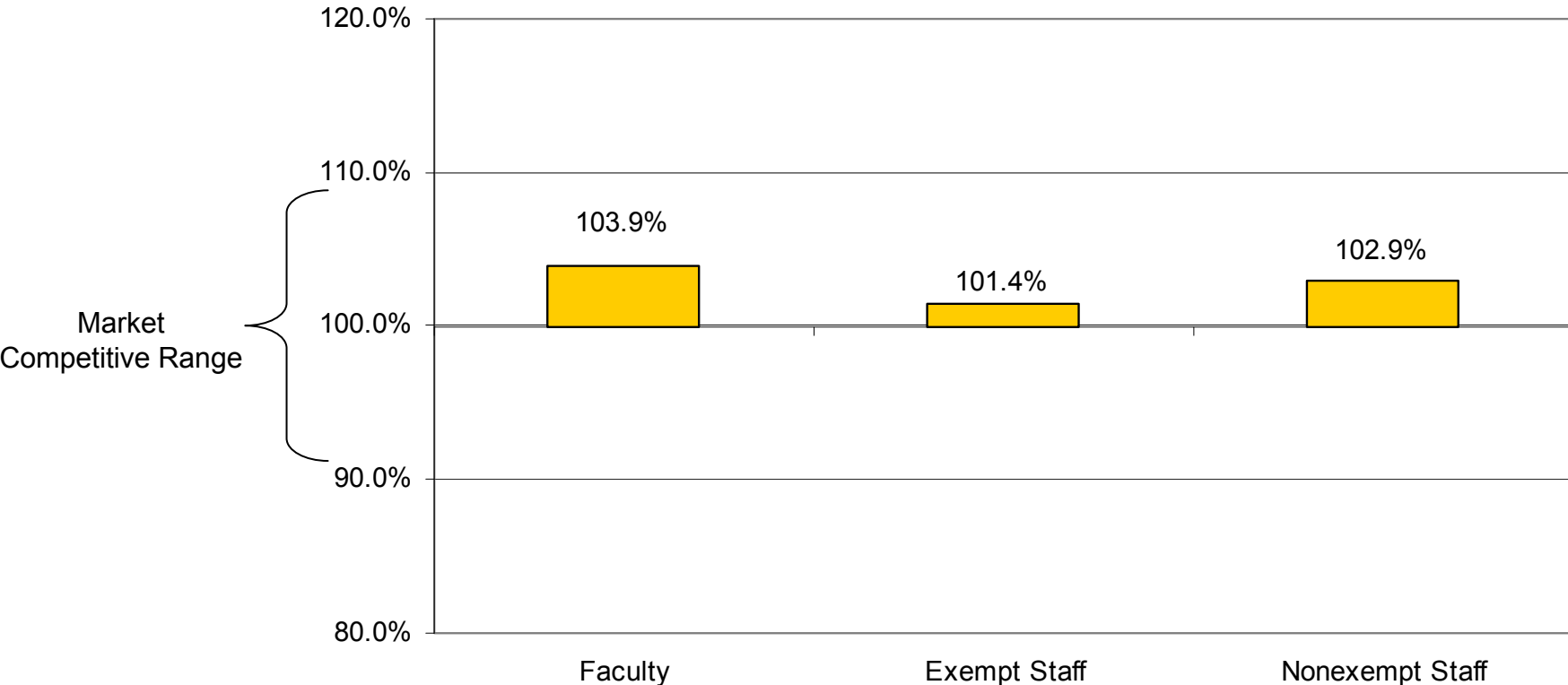
The Growing Total Reward Focus: One Example

Overall Benefits Comparison to Market



The Growing Total Reward Focus: One Example

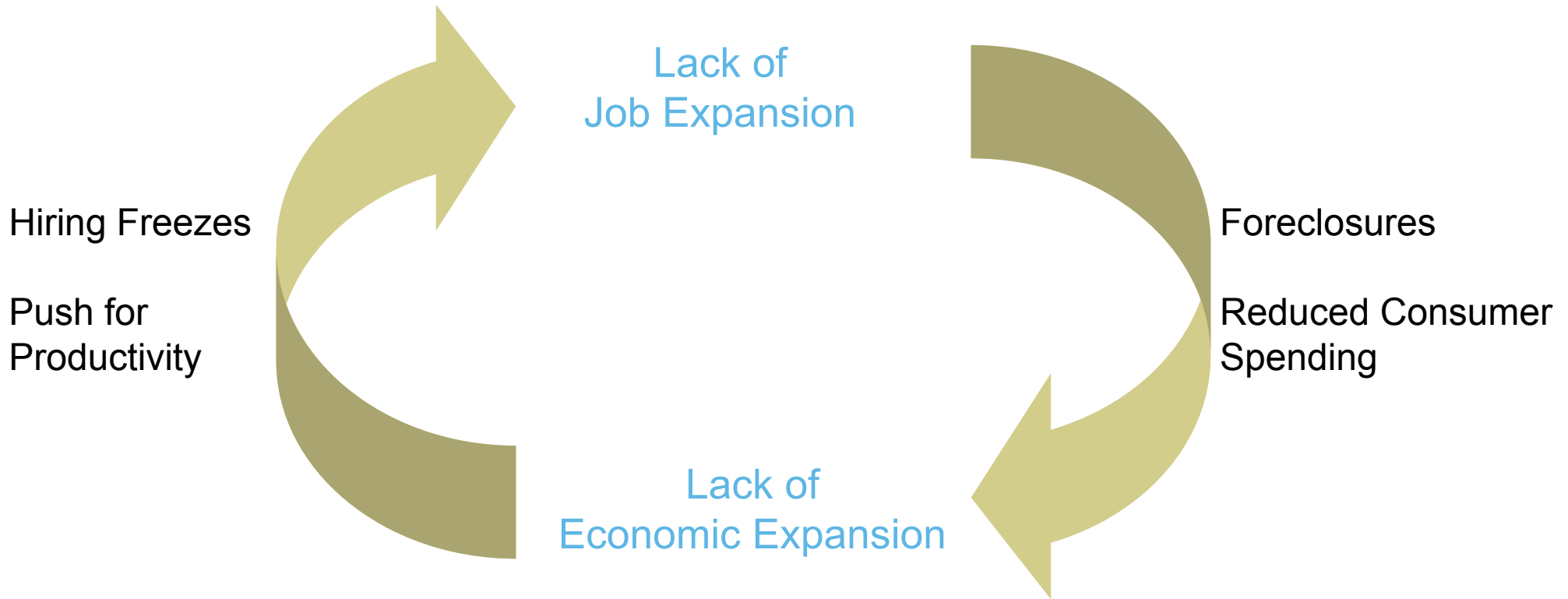
Overall Total Compensation Comparison to Market



Which of these three perspectives is the best to communicate to staff?

Trends in Salary Increases

Current Economic Outlook



2011 Compensation Planning Snapshot

Salaried Exempt Employees

Average 2009 overall salary increases: 1.8%
Average 2010 overall salary increases: 2.4%
Projected 2011 overall salary increases: 2.9%

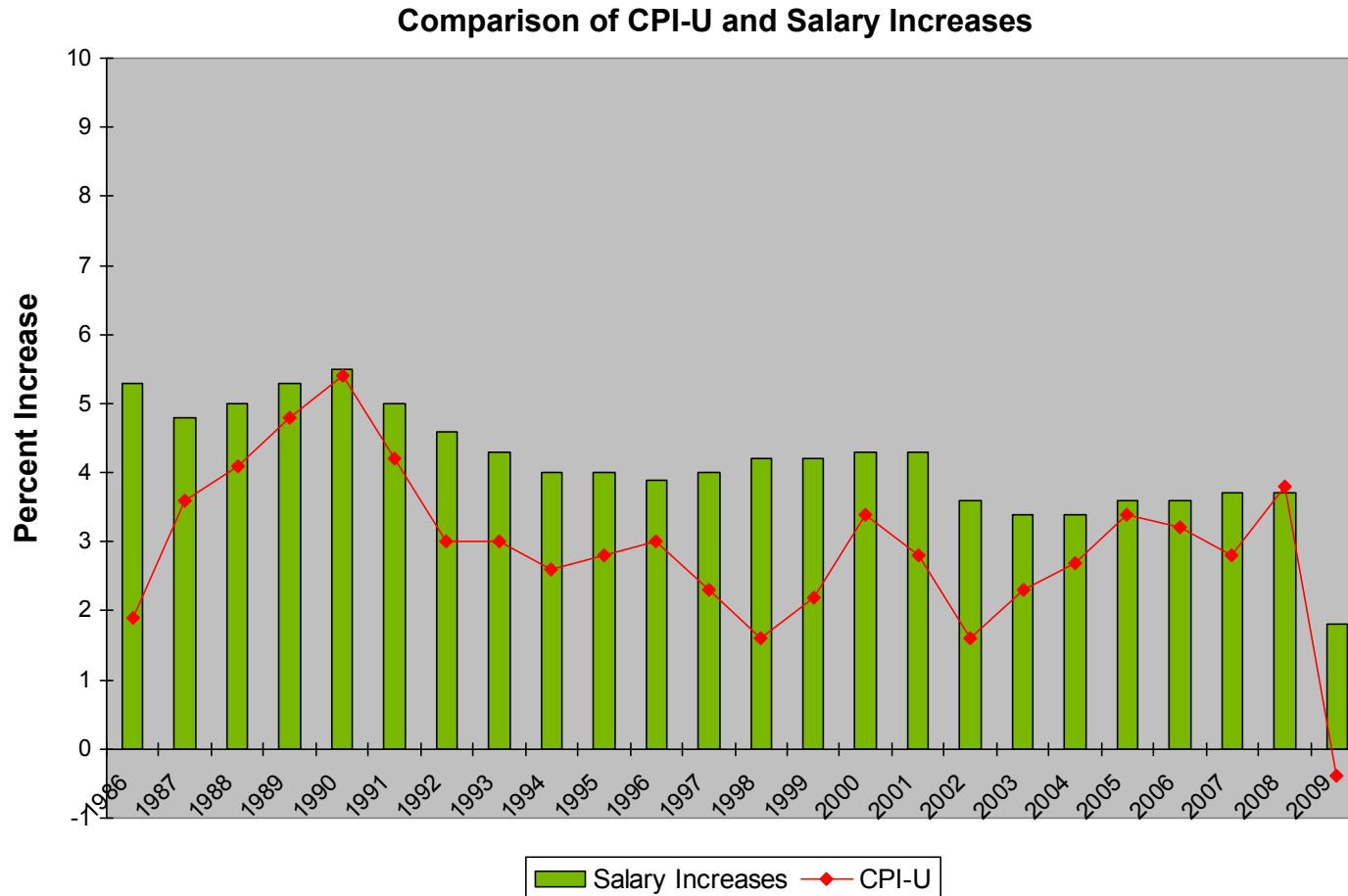
Expected 2009 variable pay spending: 12.0%
Expected 2010 variable pay budgets: 11.3%
Projected 2011 variable pay budgets: 11.8%

Salary freezes used in 2009 for 38% of organizations
Salary freezes used in 2010 for 13% of organizations
Salary freezes projected in 2011 for 3% of organizations

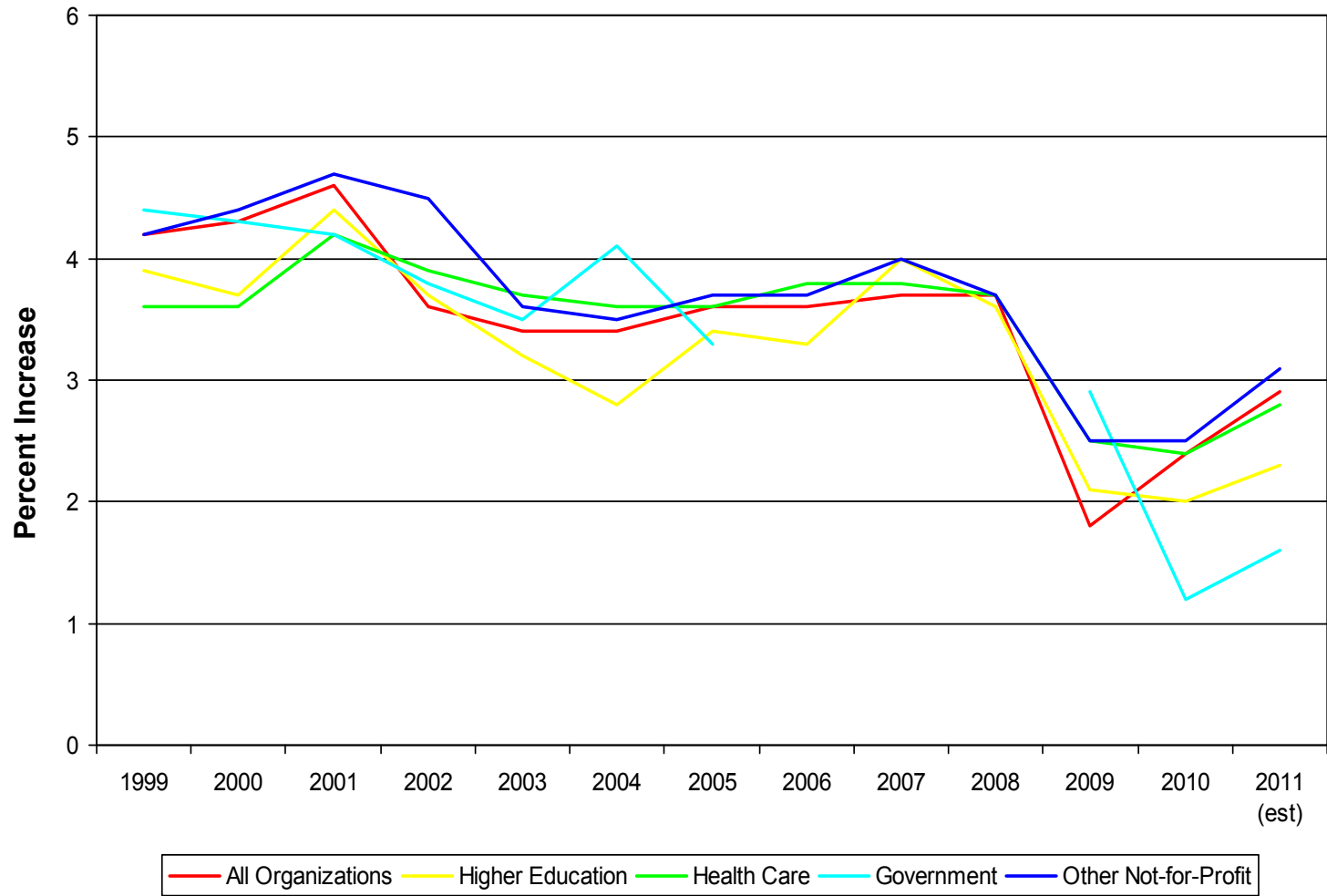
Salary cuts applied in 2009 by 8% of companies
Virtually no salary reductions reported for 2010 or 2011

Source: Hewitt Survey—U.S. Salary Increases 2010/2011

Comparison of Salary Increase Budgets to Inflation (CPI-U) from 1986 through 2009



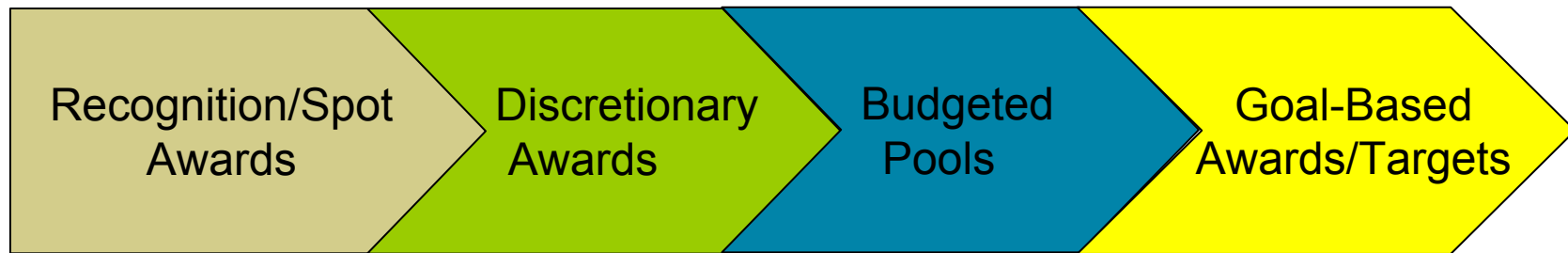
Comparison of Overall Salary Increase by Sector



Trends in Broad-Based Variable Pay

Trends in Variable Pay

The four phases of Variable Pay evolution:



Prevalence of Broad-Based Variable Pay* by Sector

| Sector | 12-Year Average for Percent Offering Broad-based Variable Pay (1999-2011) |
|--|---|
| All Organizations (Profit and Not-for-Profit) | 82% |
| Education | 39% |
| Government | 47% |
| Health Care | 53% |
| Other Not-for-Profit | 56% |

* Includes goal-based and discretionary cash plans, spot awards, and non-cash recognition

Executive Pay Spotlight

Executive Pay Climate

- The SEC and the IRS require expanded transparency of pay disclosures for all organizations
 - Publicly traded (SEC): Enhanced and continued expansion of proxy disclosure for publicly traded companies
 - Not-for-profit (IRS): New Form 990 rules and instructions, designed like “Compensation Discussion and Analysis” and “Summary Compensation Tables”
 - U.S. media, organized labor, investment institutions, and Congress all looking for “reforms” in executive pay—expect this to translate to new rules and IRS regulations

Most changes in the current climate are focused on the policies and disclosure of publicly traded companies, but some extend to not-for-profit organizations. We expect alignment between public companies and not-for-profits in the near to medium term to strengthen.

Executive Pay Climate

In the wake of the financial crisis, there has been an increased scrutiny of executive compensation over potential disconnects between pay and performance as well as governance concerns around risk mitigation

- The majority of issues being addressed with public companies have a direct impact on not-for-profit organizations
 - Excessive levels of compensation
 - Transparency and board accountability
 - Recent spotlight on financial system crisis, bonuses, backdating, and “pay-for-failure” executive severance
 - Unprecedented heightening of tension and pressure on Boards

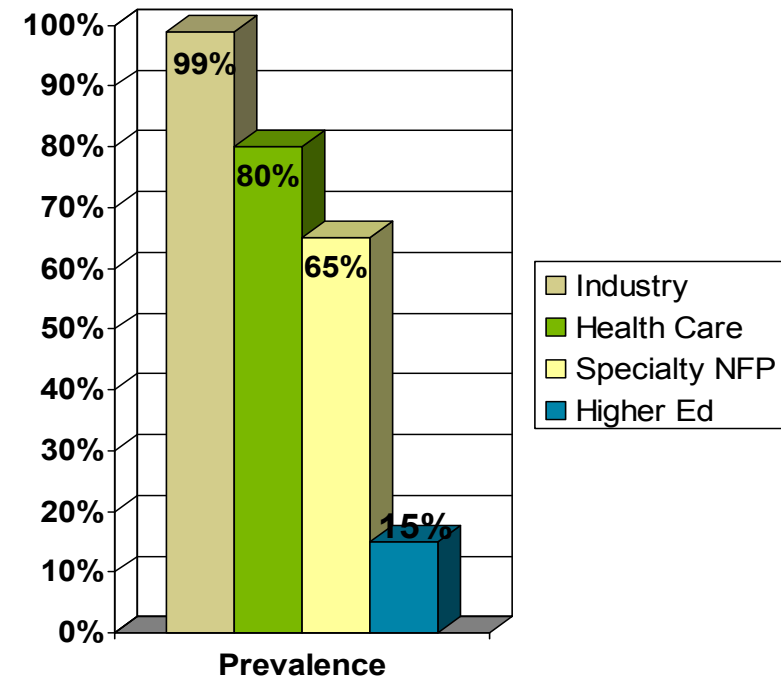
Executive Short-Term Incentive Trends

Eligibility: General Industry

- Virtually every organization has some type of short-term incentive program in place for executives
- On average, approximately half of all salaried-exempt employees are eligible for annual incentive programs

Eligibility: Not-for-Profits

- Incentive programs for healthcare and “specialty” not-for-profit organizations have been on the rise, especially with the executive level
- Increasingly, total pay opportunities are managed to achieve targeted percentile market levels at “expected performance”; with higher payouts and earnings tied to stretch/superior performance
- Short-term incentives are still relatively unusual (less than 20% prevalence) in higher education, but we expect them to expand and increase in value



Executive Short-Term Incentive Trends in Selected Larger Not-for-Profits

Primarily Among Health Care and Specialty Not-for-Profit Organizations

- More use of for-profit and general industry norms and market information to set pay opportunities
- Movement towards clearly differentiating key people in connection with “Talent Planning” processes
- Increases in “Pay at Risk” Targets to higher targeted percentile total compensation based on performance (representative targets in table, based on experience):

| Level | Annual Incentive Market Range | LTIP Market Range* |
|-------------------|--------------------------------------|---------------------------|
| President and CEO | 40% – 70% | 30% – 60% |
| COO/EVP | 40% – 60% | 25% – 45% |
| SVP | 35% – 50% | 25% – 35% |
| VP | 20% – 40% | 0% – 20% |

* Typically multi-year cash plans

Executive Long-Term Incentive Trends

Eligibility: General Industry

- Among for-profits, approximately 99% of companies use at least one form of long-term incentive compensation
- There has been a pronounced decrease in portion of long-term incentive delivered as options, and value has been replaced with **performance plans** (e.g., shares or units) and/or full-value shares (e.g., restricted stock)

Eligibility: Not-for-Profit

- While not as prevalent as the general industry, this continues to grow
 - Twenty-seven percent (27%) of not-for-profit health care organizations have some sort of long-term incentive plan
 - Less than 5% in higher education, but more common in “entrepreneurial” education systems (usually with for-profit subsidiaries)
- Given the lack of equity, these programs are typically in the form of a performance unit or cash plan over a three- to five-year period

Governance—Past vs. Present

Past

- Not-for-profits enjoyed a public presumption of enhancing value, doing good works, and having unselfish motives—interested, committed citizens as Directors
- Social experience that improved personal and system status
- Little emphasis on board skills, education, performance, or accountability

Present

- Boards must demonstrate transparently that they deserve the public's trust through their community benefits, prudent stewardship, effective decision-making, and ethical conduct
- ***Key question: “If all of our governance practices were reported in detail in the local papers of the communities we serve, would we be proud? Somewhat uncomfortable? Embarrassed?”***

Governance—Incentive Plans

Not-for-profit organizations are bound by specific regulations concerning the operation and governance of an incentive plan. Section 4958 of the IRS Code requires that:

- The plan be managed by an independent governing body
- Goals and the payout curve be approved prior to the commencement of the plan by the independent body
- Performance at the end of the plan must be audited and the payouts approved by the independent body
- Goals cannot be altered once the plan is activated
- The independent body needs to rely on market data provided by a reputable third party who works for the independent body
- The independent body needs to review the plan annually and can modify or change any part of it as it deems appropriate

TBOR2

The Taxpayer Bill of Rights Act-2 (TBOR2) specifies that a tax-exempt organization must regulate its financial relationships with its officers. Intermediate sanctions have been formed (in the form of excise taxes) to penalize individuals and organizations involved in “excess benefit transactions” (e.g., overpayment of officers). This means that an organization needs to be able to:

- 1) Demonstrate there is no conflict of interest
- 2) Provide evidence that it has collected appropriate market data and has evaluated officer compensation in comparison to its selected market
- 3) Document the determination (pay decisions)

Thank You

Paul M. Shafer, MBA

Principal/Compensation Leader for Higher Education

Hewitt Associates LLC

45 Glover Avenue

Norwalk, CT 06850 U.S.A.

Tel: 203.852.1100 Fax: 203.523.6784

E-mail: paul.shafer@hewitt.com



What Makes Government Compensation Practices Different From the For-Profit Sector?

Public scrutiny—the nature of the work—directly accountable to the public

- All government compensation is public information
- The public pays our salaries, so they are much more interested in our compensation
- Public perception that government employment is a privilege (but a privilege with a salary cap)

What Makes Government Compensation Practices Different From the For-Profit Sector?

Executive Compensation: There are limits that have to be recognized and respected— if government paid its executives at the level of private industry, or other types of non-profits, there would be an outrage

- Bonus system limited and uncommon
- Make it up as we go along

What Makes Government Compensation Practices Different From the For-Profit Sector?

Civil service system—many of our compensation practices are similar, or even identical, to those of private industry, but must be executed in the context of a civil service system

- Inflexibility is a concern (although in most cases it can be overcome)
- If it is determined that an employee is working at a higher level, we cannot always simply increase that employee's pay. The employee has to compete in a civil service examination
- Any changes to job descriptions, pay rates, or bonuses must be approved at an open public meeting by our Civil Service Commission and Administrative Board (Mayor, Managing Director, Finance Director)
- Limited bonus system

What Makes Government Compensation Practices Different From the For-Profit Sector?

Process

1. Job Analysis—Questionnaire, Interview, Observation
2. Documentation—Report, Class Specification
3. Pay evaluation—Central HR Agency pay committee/Presentation from department/occupation experts
4. Approval by Civil Service Commission and Administrative Board at Public Meeting

What Makes Government Compensation Practices Different From the For-Profit Sector?

Internal Focus

- We may have a greater concern with internal consistency
- Not necessarily a bad thing—if our employees focus on how they are paid in relation to other employees, they are not searching pay rates of other employers

What Makes Government Compensation Practices Different From the For-Profit Sector?

Hay Guide Chart Point Factor System—First step in our process—determine the relative internal worth of our jobs

- We have to compete, so we do salary surveys
- Survey of the pay practices of other jurisdiction—whether we compete against those other jurisdictions or not—Governments are reluctant to be the first to do anything and are comforted by the fact that other jurisdictions have tried something first—Like to be able to say, in public, that the practice that we are implementing is used successfully somewhere else

What Makes Government Compensation Practices Different From the For-Profit Sector?

FACTORS CONSIDERED IN DETERMINING PAY RATES

- A. Class Evaluation
- B. Internal Pay Relationships
- C. Market Rate
- D. Recruitment or Retention History
- E. Other Factors

What Makes Government Compensation Practices Different From the For-Profit Sector?

Unions:

Obligated, by Pennsylvania state law, to negotiate with unions over wages and conditions of employment

- Act 195—Civilian employees—similar to National Labor Relations Act
- Act 111—Police and Fire and other public safety employees

What Makes Government Compensation Practices Different From the For-profit Sector?

Unions:

- Public unions are more powerful than most in private sector
- FOP (Police, Sheriffs), IAFF, DC 33 (clerical and labor and trades civilian, corrections, school crossing guards), DC 47 (professional rank and file and 1st supervisory level)
- Interest arbitration determines contract with police, fire, prisons employees
- Restrictions on lay-offs
- Relationship between public sector unions and elected officials
- Collective bargaining is not always a direct negotiation between employer and union

What Makes Government Compensation Practices Different From the For-profit Sector?

FLSA—PART 553—Application of the Fair Labor Standards Act to Employees of State and Local Governments

- Exclusion for elected officials and their appointees
- Exclusion for employees of legislative branches
- Compensatory time in lieu of overtime for non-exempt employees—Under certain prescribed conditions, a State or local government agency may give compensatory time at a rate of not less than one and one-half hours for each overtime hour worked, in lieu of cash overtime compensation
- Employees engaged in fire protection or law enforcement may be paid overtime on a "work period" basis of 7 consecutive days to 28 consecutive days



How Governments Are Working to Take Advantage of the Current Economic Situation

13,500 applicants for Firefighter positions (Previous high = 9,100 in 2001)

125 qualified applicants for City Planner (usual number is 25)

Why?

What did we do?



How Governments Are Working to Take Advantage of the Current Economic Situation

Show potential employees what we have to offer

- The work itself
- Job security
- Work-life balance
- Benefits

How Governments Are Working to Take Advantage of the Current Economic Situation

What Benefits Does the City Offer?

- 10 to 25 days vacation per year (more as seniority increases)
- 15 days sick leave per year
- 11 holidays
- 4 personal leave days
- Defined benefit pension
- Relatively early retirement
- Liberal health benefits—low co-pays
- Post retirement health benefits
- Life insurance

How Governments Are Working to Take Advantage of the Current Economic Situation

HIRING BONUS—\$1,500 to \$3,000—paid in two parts: 3 months of satisfactory full-time probationary employment and after 12 months of satisfactory full-time employment

Auditor Trainee/Accountant Trainee

Graduate Engineer

Nurses

Pharmacists

Librarians

Credential Based Bonus—\$500 to \$3,000—Lump sum bonus for acquiring professional credentials or advanced degrees

Auditors-CPA

Engineers—Architects-Professional Engineer or Registered Architect; Master's Degree or Ph.D

Automotive Maintenance and Trades—ASE and EVT certifications

How Governments Are Working to Take Advantage of the Current Economic Situation

Understand Who wants to Work for Government, and Why?

What factors affect the decision to accept a job?

Between September 2000 and March 2008, surveys of recently hired entry level engineers, auditors and accountants were conducted to determine why they accepted jobs with the City of Philadelphia

Engineers were asked to rate 28 factors that may have affected their decision to accept a job position with the City of Philadelphia

Auditors and Accountants were asked to rate 27 factors that may have affected their decision to accept a job with the City of Philadelphia

Factors with the most positive impact were rated "5", and those with the most negative impact were rated "1"

57 auditors and accountants responded to the survey. At least 53 of those employees considered the factors listed in the slide to be significant to their decision

64 engineers responded to the survey. At least 55 of those engineers considered the factors listed in the slide to be significant to their decision

| Rank | Factor—Engineers | Rating |
|-------------|---|---------------|
| 1. | Job security | 4.45 |
| 2. | Benefits package | 4.37 |
| 3. | Work location | 4.30 |
| 4. | Interesting work | 4.18 |
| 5. | Stable schedule | 4.17 |
| 6. | Paid Time Off | 4.16 |
| 7. | Proximity of work location to public transportation | 4.13 |
| 8. | Experience that would qualify for other positions | 4.03 |
| 9. | Promotional opportunities | 3.97 |
| 10. | Work in same field as academic training | 3.93 |

| Rank | Factor—Auditors, Accountants | Rating |
|-------------|---|---------------|
| 1. | Job security | 4.57 |
| 2. | Benefits package | 4.44 |
| 3. | Work in same field as academic training | 4.43 |
| 4. | Flexible schedule | 4.37 |
| 5. | Stable schedule | 4.36 |
| 6. | Experience that would qualify for other positions | 4.26 |
| 7. | Work location | 4.11 |
| 8. | Paid Time Off | 4.09 |
| 9. | Interesting work | 4.09 |
| 10. | Promotional opportunities | 4.05 |
| 11. | Proximity of work location to public transportation | 4.02 |

What Has Not Been Mentioned As a Positive Factor Affecting the Decision to Accept Government Employment?

| Rank | Factor | Rating |
|------|-----------------|--------|
| 25 | Starting Salary | 2.98 |



Unique Constraints and Difficulties Faced in the Government Environment

Economy has put government in a new, mostly negative position

Pressure to eliminate many of the rewards advantages that governments have used in place of base salary

Layoffs

Salary Freeze

Furloughs

Reduction in Benefits

Delayed Economic Recovery

Public Resentment

Unique Constraints and Difficulties Faced in the Government Environment

City of Philadelphia Response

- Salary Freeze since July 2007 for all but Police and Fire
- Annual increments eliminated
- Credential based bonus eliminated
- Furloughs for non-civil service employees
- Defined contribution pension for some new employees
- New hiring restrictions
- Layoffs

Unique Constraints and Difficulties Faced in the Government Environment

On October 8, 2010, the federal government reported that 150,000 government jobs had been eliminated

77,000 census, 76,000 local governments, 7,000 state governments

Philadelphia Inquirer has called on the City of Philadelphia to reduce its workforce

Unique Constraints and Difficulties Faced in the Government Environment

Survey released July 30, 2010 by the International Public Management Association for Human Resources (IPMA-HR) and Fox Lawson & Associates—Data from 317 government employers across the country

- 60% of all organizations reported suspending pay increases, and 44% reported suspending pay structure increases
- State governments especially hard hit with 91% reporting pay freezes and 73% of state suspending pay structure adjustments

Common actions taken by organizations participating in the survey included:

- Eliminating or suspending pay for performance programs (23%)
- Eliminating or suspending incentive and bonus plans (18%)
- Lengthening the time between pay increases (13%)



Unique Constraints and Difficulties Faced in the Government Environment

“If only Nutter had the fortitude to cut an additional \$86 million, then the city could avoid a 10% property-tax hike and be better positioned for a recovery....People are struggling to make ends meet, and they are mad at all levels of government. It's hard for them to dig deeper into their pockets when they see bureaucratic waste, corruption, incompetence, and public employees enjoying steady pay hikes and Cadillac pension and health plans.”

Philadelphia Inquirer—July 26, 2010

“But what Nutter has not done is lay off workers at anything close to the pace of his counterparts in New York, Phoenix, Chicago, and other cities where hundreds of municipal employees have been sent packing.”

Philadelphia Inquirer—August 3, 2009

Unique Constraints and Difficulties Faced in the Government Environment

“City Hall retirees shouldn’t be the only Philadelphians worried about the latest report outlining the sorry state of funding for municipal pensions. Anyone who relies on city services has to be just as concerned that the mounting pension debt eventually will hit them where they live. With a growing chunk of the city budget going to fund pensions, there will be fewer tax dollars to put police on the street, keep firehouses open, pick up trash, and provide other key services.”

Philadelphia Inquirer—October 18, 2010

“The recent anger felt by the citizenry toward Wall Street and banks seems to now be focusing on the public sector as governments threaten to raise taxes to subsidize what are thought by some to be excessively generous and costly pension, medical and time-off practices”

Robert Greene—September 2010 Workspan

Thank You

Michael McAnally, MBA

Deputy Director, Office of Human Resources

City of Philadelphia

1401 JFK Blvd.

Office of Human Resources- Room 1540

Philadelphia, PA 19102

Tel: 215.686.2360 Fax: 215.686.2317

E-mail: michael.mcanally@phila.gov