SALARY SAVINGS

1. **What is salary savings?**

   Salary savings is the amount of salary expense that a department saves when a position is vacant or filled at a lower salary level than the budgeted level. For example, if the salary for a position is $4,000 per month, then the department saves $4,000 per month (plus some salary driven benefit costs) when the position is vacant.

2. **When did the Governor's Budget begin to reflect salary savings?**

   The Governor's Budget for the 1943-45 biennium was the first to include a line item for salary savings in the Expenditures by Category. As with many innovations, salary savings was implemented as a response to a particular set of circumstances. In 1942 when this budget document was prepared, both government and industry were experiencing unprecedented turnover as employees left to enter the armed forces or work in war industries. In transmitting the budget to the Legislature, Governor Earl Warren noted, "This situation in man power (sic) has increased the number of unfilled positions until it can be recognized as a measurable factor in the amounts required for salaries and wages."

3. **What is the purpose of salary savings?**

   No department has all of its positions filled all of the time. When vacancies occur or new positions are established, it usually takes some time to fill them. A position can remain vacant for a period of several weeks or several months.

   It is more efficient and accurate to continue to account for salary savings "up front" rather than having departments revert the funds at the end of the year. The salary savings adjustment has traditionally been included in the Expenditures by Category part of a departmental presentation in the Governor’s Budget.

4. **How is salary savings calculated?**

   As previously stated, salary savings is the amount of salary expense that a department saves when a position is vacant or filled at a lower-than-budgeted level. It should be the best realistic estimate of the expected savings. The average

savings for recent past years may be the best gauge. If there are any anticipated impacts on savings, which might result from new positions, reduced positions, recruiting difficulties, etc., they must be considered.

Departments will not capriciously increase salary savings to fund increased costs, especially increases in non-salary costs for operating expenses and equipment. Such an unwarranted increase results in underfunding of positions or related costs and avoidance of a decision to either (1) make other necessary reductions or (2) provide up-front funding. Conversely, salary savings should not be understated as it results in overbudgeting or avoidance of a reduction.

In a BCP, the total salaries for all of the positions is generally reduced by 5 percent to reflect salary savings. This is a standard adjustment required of all BCPs from most departments. (Exceptions may be provided for very small departments.). Further, this 5 percent is never replaced in the department's budget, it is a permanent reduction. The net total for salaries and wages (after the salary savings reduction) is then used for the appropriate calculations for staff benefits and operating expenses and equipment. There is no salary savings reduction made for either staff benefits or operating expenses and equipment, since they are calculated from the reduced salary base (this will become important later).

5. **What makes a department's salary savings level change over time?**

Generally, anything that changes the balance between costs and funding has an impact on a department's salary savings rate. For example, when a position is first established, it is funded at the first step of the salary range for that classification. If the incumbent were to stay in that position for several years, the cost of the position would increase as the person moved to higher steps in the salary range. Similarly, if a person paid at the first step were to leave the department and was replaced by someone at a higher step, the cost of that position would also increase. However, if someone paid at the fifth step of the salary range were to leave the department and be replaced by someone at the first step, the cost of the position would be reduced. Beginning in 2001-02, proposed new positions are funded at the mid-step of the salary range for that classification.

In a large department, many of these transactions occur during

the course of a fiscal year, which increase or reduce costs. Until the mid 1980s, the Department of Finance provided departments with a baseline planning estimate adjustment to fund cost increases resulting from their granting merit salary adjustments (MSAs). This adjustment would provide funding for up to 2 percent of the growth in a department's ongoing salary and wage base, as measured by the change in the Schedule 7A total from the current year to the budget year. (The Schedule 7A is a department's listing of authorized positions and related salaries which ultimately is printed in the Salaries and Wages Supplement.) If the salary and wage base increased by more than 2 percent, the department would normally have to fund this cost within existing resources, usually by increasing salary savings.

Since the mid 1980s, the Department of Finance has not generally provided a baseline adjustment for MSAs. Thus, many departments have increased their overall salary savings rate in order to fund MSAs. In some cases, departments have increased salary savings to fund inflation in operating expenses and other non-salary costs.

In addition, departments frequently request upgrades in some of their positions. This differs from an MSA in that, whereas an MSA changes the step within a salary range, an upgrade changes the salary range. In most cases, the Department of Finance will require that the cost of an upgrade be absorbed by the department within existing resources, as a condition of its approval. While the cost of a single upgrade is usually small and absorbable, especially to a large department, the cumulative impact over several years can be substantial, and may require salary savings to be increased. The same would be true if a department hires a significant number of staff above the minimum step because of their exceptional experience. (In cases where a department is forced to hire everyone in a classification above the minimum step because of labor market conditions, such as nurses and physical therapists, and has an approved "hire-above-minimum" authorization from the Department of Personnel Administration, the Department of Finance usually will provide funding through a baseline planning estimate adjustment.)

6. **If a department's salary savings level becomes too high, what can be done to reduce it?**

Just as the statewide budget can be balanced through a

combination of expenditure reductions and/or revenue increases, salary savings can be reduced by either reducing costs, increasing available funding, or some combination of the two. Expenditure reductions could include the elimination of authorized positions without reducing funding (which would bring down the 7A total without reducing the planning estimate amount), or a similar reduction in operating expenses and equipment. Available funding can be increased if the Department of Finance makes a planning estimate adjustment to increase a department's appropriation. Sometimes departments will submit BCPs for this purpose. These augmentations must always be justified. For example, if a department achieved more savings than was budgeted last year, the Department of Finance would not usually approve a BCP for salary savings relief.

When an adjustment for salary savings relief is made, however, other adjustments for staff benefits and operating expenses must be made also. As stated earlier for BCPs, staff benefits and operating expenses were calculated based on the net salaries and wages (after salary savings was taken out). This is true also for the department's budget as a whole. Staff benefits and operating expenses are budgeted for the staff who are there, not for vacant positions. Only if vacancies become higher than expected will there be excess funds for staff benefits or operating expenses.

This means that if salary savings is to be reduced and more positions are to be filled, additional funding will be needed for staff benefits and operating expenses. For example, if a department's salary savings in the baseline budget is $100,000 and this is a 10 percent salary savings rate (that is, the total salaries and wages are $1 million), and a decision is made to reduce the salary savings rate from 10 percent to 8 percent, the total cost would be more than $20,000. While the cost of the additional salaries would be $20,000, there would be an additional expense for staff benefits and operating expenses (calculated at the average rate for that department). Conversely, if the total augmentation were $20,000, the net reduction in the salary savings rate would be less than 2 percent, since those funds would be divided between salaries, benefits, and operating expenses.

7. **The budget reflects salary savings both in terms of positions and dollars. Which is more accurate?**

Since salary savings is the gap between gross position costs and available funding, it is almost always calculated in dollars by a departmental budget office. Essentially, the dollar salary savings is the real salary savings as far as the department is concerned. Departments then use a formula based on average salary cost to calculate the position equivalent of the dollar salary savings amount. Similarly, any Department of Finance calculations or analysis of options should be based on the dollar salary savings rate initially, and then translated into position equivalents.

8. **How do salary savings calculations enter into baseline adjustments for employee compensation?**

   There is a difference between the way the salary increase and the staff benefit increases are treated. Salaries and wages are displayed initially at the fully authorized level in the Expenditures by Category, without salary savings taken out. Consequently, the salary increase is applied to this authorized level without salary savings taken out (yet). This amount is displayed on the salary increase line in the Expenditures by Category. The salary savings associated with the salary increase is then calculated separately and added into the salary savings line to increase the amount of salary savings. The net augmentation, that is, the gross salary increase minus the salary savings, is the amount entered into the planning estimate system. However, that number is not displayed in the Expenditures by Category. For example, if the gross salary increase is $100,000, and salary savings is 7 percent, then the salary increase line in the Expenditures by Category would show $100,000, the salary savings line would be increased by $7,000, and the planning estimate total would be increased by $93,000 (for current year and budget year, respectively).

Costing staff benefits (salary-driven benefits for retirement, OASDI and Medicare) is simpler. The budget galley amounts for these benefits are already net of salary savings. Therefore, they can be increased according to the appropriate employee compensation formula, and no subsequent adjustment for salary savings is needed. For such staff benefits, the amount added to the Expenditures by Category is the same number entered into the planning estimate system. The line for staff benefits is increased by the sum of the individual staff benefit adjustments reflected in the planning estimates.

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