



## **STAFF REPORT**

DATE: May 8, 2018

ITEM #: 5

**TO:** Mayor and City Council

**FROM:** Jake Foster, Assistant City Administrator

**AGENDA ITEM:** Performance Pay for Compensation Policy

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### **BACKGROUND:**

At their December 5, 2017 meeting, Council adopted a step and grade compensation policy for City staff with the expectation that their desire for a performance-based compensation model be incorporated into the City's compensation policy in the future. Any additional bonus, merit pay, or performance incentive programs would be implemented in addition to the City's current step-and-grade plan.

At their April 11, 2018 meeting, the Human Resources Committee discussed adding a performance pay component to the existing compensation plan. Upon further analysis, the committee decided they would like further Council direction as whether or not to present them with a draft policy. The committee members were not comfortable with choosing whether or not a draft should be presented.

Using materials from the League of Minnesota Cities and soliciting input from other cities throughout Minnesota, various models for performance-driven compensation within municipalities have been identified while keeping Minnesota state law in consideration. It is important to note that staff received very little response from other cities in regards to performance incentive programs that have been implemented throughout the state.

### **ISSUE FOR DISCUSSION:**

Should Council direct the Human Resources Committee to present a draft of a performance-based compensation policy to be added to the current step and grade system?

### **PROPOSAL DETAILS/ANALYSIS:**

As stated by the League of Minnesota Cities (LMC) in Chapter 4 of their Human Resources Reference Manual, "Cities must be careful when awarding lump sum incentive pay to ensure the payment is allowable under Minnesota state law. Cities are prohibited from awarding bonus pay because this may be considered a gift and, therefore, an unlawful city expenditure. Any compensation must be tied to job performance" (p. 13).

LMC also recommends that cities take the following measures when establishing and implementing incentive/performance-based compensation programs:

1. Establish specific criteria or goals in advance that must be met in order to receive the incentive pay – preferably at the beginning of the year or performance evaluation period.
2. Have the city council approve the pay incentives as a formal part of the employee compensation plan for the year.
3. Document that employees know about the incentive pay and know how they can go about earning it. (p. 13)

The measures referenced above are described within LMC's "performance incentives" model, but are relevant to each of the following models.

While taking these points into consideration, LMC further suggests categories as to how performance or incentive-based compensation can be implemented within municipalities. An example from New Ulm, MN fits within the "performance incentive" category, and additional information has been supplied via attachment.

### **Merit Pay**

Merit pay can be centered on base pay increases or lump sum payments based on an employee's general performance, on reaching assigned goals, or completing projects successfully.

Included in the City's current step and grade system are evaluations where employees receive a score from 1-5. Step increases are only given to employees who receive satisfactory performance evaluations. By this definition, the City has already implemented a merit pay system. However, other features of a merit system could be added to where employees receive one-time payments or lump sums based on these satisfactory reviews. Additionally, if an employee meets pre-determined performance measures, completes a pre-designated project in a satisfactory manner, or assumes additional responsibilities that are not outlined in their job description, merit pay bonuses (or step increases) could be distributed in this system. It is important to note that this representation of the merit pay system has some overlap with the "performance incentives" system.

### **Broadbanding**

This concept is newer to the public sector, and revolves around assigning the same pay grade to multiple positions that are classified under the same employment category. For instance, the "accounting tech," "accountant," and "senior accountant" positions could all function on the same pay grade or pay band. This would allow the "accounting technician" to be paid at the same rate as the "accountant" or even the "senior accountant" if he/she increases his/her productivity, develops new skills, or pursues additional training without having to completely reclassify his/her job.

This concept may be a bit limited as the City of Lake Elmo has a lean staff, and it is not likely that there will be a need for adding the additional job descriptions needed to support such a model anytime in the near future.

### **Performance incentives**

As previously stated, there is a bit of overlap between the merit pay system and performance incentives. Generally speaking, performance incentives are typically one-time lump sum payments, but they could be received in the form of an ongoing pay increase. Much like the merit pay system, performance incentive pay could be earned by completing previously determined goals. However, unlike the merit pay system, these goals could apply to work teams, departments, or even the entirety of the city staff. If the predetermined goal is met in a satisfactory manner, each employee who is responsible for accomplishing that goal would be rewarded.

New Ulm has implemented a policy that would be classified as a performance incentive program that is outlined in one of the attachments.

### **Skill or competency-based pay**

This concept is found within a few of the other pay models, but it is the idea that employees can earn additional compensation for acquiring new skills or competencies.

**Combination plans**

As there are advantages and disadvantages of each of these pay plans, attributes from various programs can be integrated with each other and incorporated into the City's overall compensation plan. As discussed in the attached Chapter 4 of LMC's Human Resources Reference Manual, a City could incorporate any or all of the following into their compensation plan:

1. Small step increases
2. Incentive pay based on departmental or team goals
3. Skill-based pay for certain job classes
4. Competency-based pay for managers.

Of course other compatible attributes or concepts could be included outside of those outlined by LMC above.

**Program eligibility**

A staff member at LMC mentioned that she had success implementing these types of merit/performance systems in other cities. One additional concept that she specifically noted was that performance or merit pay could be made to be only available to employees once they are at the maximum step within a step and grade plan. This would allow employees to continue to earn beyond the City's maximum step within their grade, and be further incentivized to perform well and continue their employment with the City.

**FISCAL IMPACT:**

To be determined.

**OPTIONS:**

1. Request that the Human Resources Committee, along with staff, create a draft of a performance-based compensation policy to be reviewed by Council at a future meeting.
2. Make no request of the Human Resources Committee, and choose not to pursue performance-based compensation any further.

**ATTACHMENTS:**

1. League of Minnesota Cities – Human Resources Reference Manual: Chapter 4 Compensation
2. New Ulm, MN's Performance Incentive Program



## HUMAN RESOURCES REFERENCE MANUAL

# Chapter 4 Compensation

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## HUMAN RESOURCES REFERENCE MANUAL

# Chapter 4 Compensation

*Learn effective and legal compensation practices and policies. Find explanations of compensation plans and other types of pay increases. Review minimum wage and overtime laws. Understand payroll issues like when wages are due and permitted withholdings and deductions. Links to a self-audit checklist of compensation practices and selected forms, policies and a model compensation plan for small cities.*

### RELEVANT LINKS:

HR Reference Manual,  
[Chapter 5.](#)

HR Reference Manual,  
[Chapter 1](#) Section IV-B State  
and Federal Laws regarding  
Compensation.

## I. Compensation and benefits

A total compensation program for employees contains both compensation and benefit components. Providing competitive compensation is just as important for recruiting, retaining, and motivating city employees as it is with private sector employers. Some elements of a total compensation program may be difficult to classify strictly as “compensation” or only as a “benefit.” For example, employee use of city cell phones may be considered a “benefit”, but depending on reimbursement strategies, may become taxable “compensation”. Or, is compensation that is deferred just compensation, or is deferred compensation also a benefit?

For purposes of this chapter, compensation includes salary and wage issues, such as compensation plans, and minimum wage and overtime laws. It also includes payroll issues such as pay periods, withholdings and deductions. The benefits chapter is devoted to leaves and other time off, and selected other events and programs such as employee recognition, tuition reimbursements, membership, uniforms and child care and housing assistance as well as insurance benefits.

## II. Applicable state and federal law

A city needs to be aware of the many state and federal laws affecting all aspects of the employment relationship, from application and hire, through compensation, benefits and protections while on the job, finishing with end-of-employment requirements and sometimes continuing employer obligations in a post-employment relationship.

Those laws having the most impact for a city when establishing and maintaining employee compensation are discussed throughout this manual with regard to each applicable topic.

This material is provided as general information and is not a substitute for legal advice. Consult your attorney for advice concerning specific situations.

## RELEVANT LINKS:

HR Reference Manual,  
[Chapter 1.](#)

[“Compensating Employees  
to Achieve Results,”](#)  
*Minnesota Cities* (May/June  
2000, p. 19).

[Classification and  
Compensation Plan  
Framework for Smaller  
Cities, LMC Model.](#)

### III. Salary and wages

There are a number of laws impacting the way in which cities pay their employees, regulating such items as overtime eligibility and payment, pay equity (comparable worth), and payroll procedures and withholdings. However, the city must keep in mind the overall goal of employee compensation, which is to recruit and retain a productive and reliable workforce. This section of the of the Chapter discusses various methods for meeting this overall goal as well as related issues that impact employee wages, pay plans, and payroll procedures.

#### A. Compensation plans

In establishing or updating its employee compensation plan, the city may want to start by listing the goals and priorities of the organization. Does the city want to be known for outstanding customer service? Does it prioritize communication with residents? Is fiscal responsibility the top concern? Is increasing employee capacity or competency/skills a focus?

Does the city wish to reward employees based on their contribution to the overall success of the city or the employee’s specific department? Whatever the priorities, the city should establish the employee compensation plan with these in mind and then build compensation models and tools providing employees incentives to achieve the desired results.

In addition to considering the goals and priorities of the organization, the city must be mindful of other factors in establishing its compensation plan. The city should consider both internal equity considerations (i.e., whether there are reasonable relationships between various job classes within the city) and market considerations (i.e., whether there are reasonable relationships between job classes and their appropriate comparison groups in the larger market). In order to do this, there are some preliminary steps the city may want to take prior to establishing its compensation plan:

- Job classification/review.
- Job evaluation (especially as it relates to pay equity compliance).
- Market comparison.

#### 1. Job classification

One of the first steps in establishing a compensation plan is to review job duties and responsibilities and classify jobs accordingly.

## RELEVANT LINKS:

LMC Sample [Job Description](#).

U.S. Equal Employment Opportunity Commission: [The ADA: Your Responsibilities as an Employer](#).

LMC information memo, [FLSA: Determining Exempt vs. Non-Exempt Status](#).

Job classification establishes the foundation for grouping jobs into categories in order to compare them both internally (with similar jobs within the city) and externally (with similar jobs in the larger market).

Ideally, each position in the city should be reviewed to determine the following:

- What is the basic purpose or objective for the position? In other words, why was the position created?
- What are the primary or essential functions the individual in the job performs? (For purposes of the Americans with Disabilities Act (ADA), the essential functions should be defined carefully as they are likely to come into play if the city is ever challenged under the ADA.)
- What are the criteria by which the position should be judged? In other words, how will the city know if the employee is doing a good job?
- What basic types of knowledge, skills, and abilities must the employee possess in order to successfully perform the duties of the job?
- What are the minimum requirements of the position with regard to education and experience, certifications, training, and licenses?
- What are the types of education, experience, certifications, training, or licenses that, while not required, would be helpful or desirable?
- Who does the position report to and which positions, if any, does it supervise?
- What is the degree of supervision received in the position; i.e., does the person work independently with just general guidance or do they receive substantial day-to-day supervision in the position?
- Is the position exempt (not eligible for overtime) under the Fair Labor Standards Act (FLSA) or nonexempt (eligible for overtime)?

Once these items are determined, they can be used to create or update a job description for the position. Job descriptions are the guiding document for many aspects of job classification, compensation, pay equity compliance, recruitment, performance evaluation, and sometimes discipline and termination. Therefore, it is a good practice for cities to develop job descriptions and periodically update them.

Once a city has completely reviewed each position and developed or updated job descriptions, it may be possible to group similar jobs into job classes. For example, in most cities, each police officer performs very similar duties to other police officers. One job description and one job class should serve for most of the police officer positions in the city.



## RELEVANT LINKS:

[Minn. Stat. § 471.991.](#)

See Section III-A-2, *Job evaluation and pay equity*.

[Minn. Stat. §§ 181.66 - .71.](#)

See LMC information memo, *Local Government Pay Equity Act: An Overview*.

MN Mgmt. & Budget: [State Job Match Job Evaluation System](#) (May 2009).

[Minn. Stat. § 471.994.](#)

The statute on pay equity in local governments defines job class as “one or more positions that have similar duties, responsibilities, and general qualifications necessary to perform the duties, with comparable selection procedures used to recruit employees and use of the same compensation schedule.” This is a useful definition for cities to use in making decisions about which positions to group together into one job class.

## 2. Job evaluation and pay equity

Minnesota law requires cities to analyze their pay structures to ensure women are not treated less favorably than men when they are performing work of similar value. In other words, cities need to ensure their wage structure doesn’t provide higher pay levels for jobs performed mostly by men than for similarly valued jobs performed mostly by women.

Therefore, after classifying the city’s jobs and developing job descriptions, the city must evaluate each job class in terms of skill, effort, responsibility, working conditions, and other relevant work-related criteria. Based on these criteria, the city assigns a value or “points.” There are a number of job evaluation systems available to help a city conduct this study or, in theory, the city can develop its own method (but would then need to ensure the method is defensible as being nondiscriminatory).

One job evaluation system available to cities is called the State Job Match. It is a listing of benchmark jobs typically used by cities throughout the state (e.g., city clerk, deputy clerk, clerk-treasurer, maintenance supervisor, etc.) for which a range of job values (points) has been determined. The city can simply compare its job classes to the ones on this list and assign the points in accordance with the State Job Match system. For example, a city might compare its job description for its maintenance supervisor to the description of the maintenance supervisor in the State Job Match, determine how close the match is, and then assign points accordingly.

Alternatively, the city can hire a consultant to do the job evaluation (assign job value points) for the city. The advantage of using a consultant is that employees will generally perceive an outside consultant as less likely to be biased in how they assign points. Some systems require the employees to complete a detailed questionnaire about their job duties; others require only an up-to-date job description.

The city should make sure they understand the system being offered and, ideally, compare it to other systems before choosing the one to be used.

After a job evaluation system is in place, state law requires the city update it to account for new job classes and changes in factors affecting the comparable worth value of existing job classes.

## RELEVANT LINKS:

[Instructions for Completing Pay Equity Implementation Reports](#), MN Mgmt. and Budget, Pay Equity Office, (Nov. 2016). [Local Government Pay Equity](#), MN Mgmt. and Budget. Minn. Stat. § 471.994.

[Minn. Stat. § 471.991.](#)

[Instructions for Completing Pay Equity Implementation Reports](#), MN Mgmt. and Budget, Pay Equity Office, (Nov. 2016). [Local Government Pay Equity](#), MN Mgmt. and Budget.

MN Management and Budget: [Pay Equity Software Instructions](#).

[Minn. Stat. § 471.992.](#)

[Minn. Stat. § 471.993.](#)

[Minn. Stat. § 471.994.](#)

[Instructions for Completing Pay Equity Implementation Reports](#), MN Mgmt. and Budget, Pay Equity Office, (Nov. 2016).

[Minn. Stat. § 471.995.](#)

While a city can change systems periodically, there are certain legal requirements that come into play (such as notification to the commissioner of the Minnesota Department of Management and Budget), so the city should be mindful of these requirements when making such changes.

Once the points (or job value) are determined, the city must look at each job class to determine if it is “male-dominated,” “female-dominated,” or “balanced.” These terms are defined in the pay equity statute.

The final step is to compare job classes of equal or similar value to ensure there is no pattern in which male-dominated job classes are consistently paid more than female-dominated job classes. Balanced classes are considered “neutral.”

The State of Minnesota Department of Management and Budget has a web-based computer application which a city can use in order to determine whether there is a pattern of inequity in its pay structure. Additionally, jurisdictions can log on privately to the application to simulate changes without actually submitting a report.

There are a number of provisions in the pay equity law cities should consider as they implement or update their compensation plan and pay equity report to the state:

- An arbitrator must consider pay equity, including the results of any job evaluation study and any employee objections to the study together with other standards appropriate to interest arbitration (i.e., arbitration over the terms of a union contract).
- The provisions of the Pay Equity Act do not diminish a city’s responsibility to bargain in good faith.
- The city must ensure wages for each position are reasonable when compared both internally and externally.
- Job evaluation systems must be updated to account for new job classes and changes in factors affecting the comparable work value of existing job classes.
- Cities must notify the commissioner of the Minnesota Department of Management and Budget when substantially modifying its job evaluation system or adopting a new system.
- Cities must meet and confer with employee unions on the development or selection of a job evaluation system.
- A report containing the results of the job evaluation system must be provided to the union to be used by both parties in contract negotiations.

## RELEVANT LINKS:

[Minn. Stat. § 471.9966.](#)

[Minn. Stat. § 471.997.](#)

[Minn. Stat. § 471.9981.](#)

[Minn. Stat. § 471.999.](#)  
[Minn. R. 3920.1200.](#)

[Minn. Stat. § 471.993.](#)

- It is not an unfair labor practice for a city to set aside funds for the purpose of correcting inequitable relationships.
- The results of any job evaluation system can be used in court or by the Human Rights Department in any proceeding or action alleging discrimination.
- Cities with one or more employees must file a pay equity report with the Minnesota Department of Management and Budget, Human Resource Division every third year as required by the department.
- If a city is found in noncompliance, a notice will be issued to that city and the city may submit information for reconsideration of the finding. Ultimately, if the city is found not in compliance, the city may be subject to fines and/or penalties through reductions in state aid. However, the city may appeal the penalty to the commissioner for a hearing by an administrative law judge. The Minnesota Department of Management and Budget monitors compliance on an ongoing basis and reports to the legislature annually.

### 3. Market comparisons

Once the city has classified its employees, developed job descriptions, and assigned points and rankings within the city, the next step is to compare the various job classes to appropriate job categories and classes in the market.

Cities are not legally required to pay employees the market rate for their job. The state's pay equity law is primarily focused on internal relationships between all of the jobs in the city (i.e., it focuses on comparing jobs of a similar nature within the city to make sure that they are paid similarly). However, state law also requires the city to ensure wages for each position are reasonable when compared to similar positions with outside employers.

The market for any given job class can be determined in a couple of ways. It is up to each individual city as to how they want to define their market.

For example, the city will probably want to determine whether they generally recruit new employees from similarly situated cities, from county government, from smaller cities, from the private sector, from the nonprofit sector, or from other sources.

Exit questionnaires or exit interviews often provide other important information. Does the city lose employees to the private sector, to county or state government, other city governments, etc.? In addition, the city will want to look at whether they recruit from or lose employees mostly within their own region of the state, other regions of the state, or outside Minnesota.

## RELEVANT LINKS:

[LMC Salary and Benefits Survey for MN Local Governments](#)

All of these factors may be different for different job classes, and therefore, the city may want to define the market differently for different job classes.

Once the city has determined its market, it will need to look for appropriate comparisons from that sector/region.

There are a number of sources for these data. For example, the League of Minnesota Cities, the Association of Minnesota Counties, and the Association for Metropolitan Municipalities jointly sponsor a salary and benefits survey of benchmark positions throughout Minnesota. Member cities and participating organizations are allowed access.

There are also many private sector salary surveys, many of which include information from the not-for-profit sector. Unfortunately, the cost and availability of these surveys sometimes make it difficult for cities to obtain them. This is one reason many cities choose to hire compensation consultants to conduct market studies for them.

Market survey data is typically used to establish a salary range for each job class in the city. This is accomplished in conjunction with an established “pay philosophy” which is generally determined by or in consultation with the city council. For example, the city might have a pay philosophy stating employees will be paid right at or near the market rate. In this case, they might establish the midpoint of a salary range at or close to that market rate. Another city might have a philosophy stating it wants to pay employees substantially above the average so it doesn’t lose employees to competitors. In this case, the city might establish the pay rate at the 75th percentile of the market.

While the city could simply adjust an employee’s wage rate each year to match the market rate, it is far more common for cities to establish salary ranges. The advantage of a salary range is it can be used to reward employees for longevity or performance. For example, the city may want to establish a practice of hiring employees below the market rate and then rewarding them through pay increases for years of service (and/or performance) until they are eventually paid at or above the market average.

In recent years, some cities have begun reviewing total compensation with market survey data. Total compensation not only includes a comparison of salaries and ranges, but also the cost of benefits, the cost of retirement benefits, and any post-retirement health care costs for various benchmark jobs.

## **4. Types of pay systems**

There are several different types of pay systems commonly used by cities and several newer types of systems used in the public sector.

The major different types are discussed in the paragraphs below, but whatever type of pay system the city chooses to implement, it should keep in mind that advance communication to employees and training of supervisors and managers is critical to its success.

Also, with employees who are represented by a union, new pay plans generally must be negotiated into the contract. Unions are usually more likely to agree to pay systems that can be shown to be objective and fair. Compensation or benefits cannot be offered to a union employee without negotiating it. The union is the exclusive bargaining representative for wages and terms and conditions. It cannot be bypassed on wage or benefits issues regardless of how innocuous or beneficial to the employee.

An ideal approach is for the city to establish its goals and mission but then have employees, supervisors, managers, and union leaders provide feedback on the intended components of the compensation plan to implement those goals.

### **a. Traditional step pay plans**

In traditional public sector pay plans, movement through the assigned pay range is accomplished by established steps (e.g., each step represents a percentage pay increase, usually between two percent and five percent). Steps are generally given based on longevity with the city (e.g., the employee receives a step increase for each year of service). Sometimes, the city establishes performance criteria as well. For example, an employee might be eligible for a step increase on his/her anniversary date if the employee receives a satisfactory performance review.

The advantages of a step plan are predictability for employees and for budgeting purposes. Also, this type of plan (especially if based solely on longevity) is often perceived as being fair by employees and union groups.

The primary disadvantage of a step plan, especially if based solely on longevity, is that it does nothing to motivate employees to perform at higher levels.

Critics of step plans based on longevity say these plans encourage employees to simply “put in their time” or work at the minimal levels necessary to retain the job.

## RELEVANT LINKS:

Another criticism of traditional step plans is that the only method by which an employee can receive significant pay increases or move up a pay grade is through reclassification of his/her position. Reclassification refers to an action by which an employee's job class is reviewed for possible assignment to a higher salary grade.

For example, a civil engineer I might request consideration of a reclassification to civil engineer II, a job class which is assigned a higher pay grade. The basis for reclassification is generally that the employee's duties have changed over time, and he/she is now performing higher level duties generally assigned to the higher job class.

Because this is the only method to reward high performing employees (under this type of pay plan), supervisors often seek reclassifications merely for this reason.

### **b. Merit pay**

Merit pay includes pay increases or lump sum payments based on an employee's general performance in the job or on reaching assigned goals or completing projects successfully. Merit pay plans are often set up in conjunction with a step pay plan, except the step increases are given only on the basis of merit or performance. For example, in a merit pay plan, an employee may be eligible to receive a step increase once per year but the determining factor is his/her performance throughout the year. The performance is often measured through a formal performance evaluation process, but it can also be a reward for other things such as completion of a particular project or for assuming additional work duties.

Sometimes organizations budget a certain percentage of wages (e.g., two percent of the city's overall payroll) to be allocated among employees based on merit. Supervisors are then asked to make judgments about how the money is allocated among employees. In this type of situation, some employees may receive no merit pay or step increase and others may receive more than one step.

Merit pay plans can be attractive to organizations because they are viewed as tools to reward and retain employees who work harder, produce more and regularly pitch in to help. These pay plans reward for performance, rather than just "time on the job." They can also be viewed as good for employee morale if employees who do put forth the extra effort feel they are being rewarded for it.

## RELEVANT LINKS:

Merit pay is often criticized as not being objective. In other words, supervisors reward the employees they like and punish the employees they don't like through merit pay. Proponents of merit pay like it because it can be a good motivator for higher levels of performance.

Some best practice approaches with implementing merit pay include:

- Have administration and Human Resources review all departmental decisions on merit pay for consistency between departments **before** they are communicated to the employee.
- Establish written guidelines and procedures about how merit pay will be earned and paid **before** the program is adopted and in advance of the time employees can begin earning it (before the beginning of their performance review period).
- Train supervisors **before** the program is put into place on how the system works, what the criteria should be for making judgments about employee's performance. Buy-in from supervisors is crucial to merit pay plan success.
- Depending on the city compensation philosophy, consider limiting the percentage of pay increase subject to merit pay, or structure the pay increases carefully to avoid the problem of falling behind the "market." There is a potential for employee groups to lag the market if the plan isn't structured carefully.
- Consider structuring the city's pay plan so there are opportunities for everyone to "shine" and receive rewards. For example, a city may consider a moderate "across-the-board" adjustment, a small percentage for performance pay, and a small amount available for one-time lump sum incentive pay for employees who complete major projects or established goals. Some organizations devote a small percentage to "team pay" for goals that entire teams achieve together.

### c. Broadbanding

Broadbanding is a relatively new concept for the public sector. The theory behind broadbanding is that more traditional pay systems do not reward higher levels of performance, competence, or training.

In other words, two employees may receive equal pay for equal work under traditional methods even though one of the employees is a far higher performer. When this is the situation, critics argue, the higher performing employee is driven out of the organization to seek an employer that will reward the high performer.

## RELEVANT LINKS:

[A.G. Op. 107-A-3 \(Jan. 22, 1980\).](#)

[Minn. Stat. § 471.895.](#)

Broadbanding seeks to give the organization greater ability to reward higher levels of performance by creating larger pay ranges. For example, instead of having one pay grade for a clerk typist and a different pay grade for senior secretary, an organization assigns one larger pay grade for all office support staff that encompasses the market rates for both of these positions.

In this way, the clerk typist can seek to be paid at the same higher rate as the senior secretary if he/she pursues additional training, acquires new skills, or increases his/her productivity without asking for a formal reclassification of his/her position.

### **d. Performance incentives**

Some cities establish systems to reward employees through incentive pay. For example, a city may establish goals for each employee, for work teams, for departments, or even for the entire city.

If and when those goals are reached, the employee(s) responsible for reaching them receive incentive pay.

Performance incentive pay is usually a one-time, lump sum payment made to employees, but it could also be an ongoing pay increase. Cities must be careful when awarding lump sum incentive pay to ensure the payment is allowable under Minnesota state law. Cities are prohibited from awarding bonus pay because this may be considered a gift and, therefore, an unlawful city expenditure. Any compensation must be tied to job performance. In order to avoid problems under Minnesota statutes, the League encourages cities to take the following measures when establishing incentive programs:

- Establish specific criteria or goals in advance that must be met in order to receive the incentive pay—preferably at the beginning of the year or performance evaluation period.
- Have the city council approve the pay incentives as a formal part of the employee compensation plan for the year.
- Document that employees know about the incentive pay and know how they can go about earning it.

### **e. Skill or competency-based pay**

Some pay plans reward employees for acquiring new skills or competencies. This type of plan requires the city to develop lists of skills or competencies that it wishes to reward throughout the organization and for each individual job class or position.



## RELEVANT LINKS:

For example, for clerical job classes, the organization may wish to reward those employees who learn a new software program.

Throughout the organization, however, the city may wish to reward any employee who learns how to conduct effective meetings. Once the city has established the skills and competencies it wishes to reward for each job class, then it can establish a pay system that rewards employees for developing that new skill. For example, an employee who earns a certification in a particular computer software program might receive a step increase.

Skill or competency-based pay systems have several advantages. They target wage increases to the precise skills and competencies the organization wishes to encourage, so in this respect it is a very efficient use of funds. They also can be used to encourage employees to develop skills preparing them for promotions in the city; this ensures the city has internal candidates ready for promotions when they occur.

Finally, this type of pay system is generally accepted by employees as “fair” as long as the criteria for developing the skills and competencies is applied consistently and uniformly and supervisors and managers are well-trained in how to implement the system.

One disadvantage of skill or competency-based pay systems is wages can creep up over time as increasing numbers of employees take advantage of the opportunities for pay advancement. However, a counter argument can be made that the city is reaping the rewards of having a more highly skilled and efficient work force.

### **f. Combination plans**

Because there are advantages and disadvantages to every type of pay plan and because different employees are motivated by different types of reward systems, some organizations choose to incorporate several different types of pay systems into one overall plan. For example, a city’s compensation plan might incorporate all of the following:

- Small, longevity-based step increases.
- Incentive pay based on departmental or team goals.
- Skill-based pay for certain job classes.
- Competency-based pay for managers.

While this type of combination plan may meet many different goals, it can be difficult and time-consuming to administer and confusing (or potentially viewed as unfair or discriminatory) to employees.

## RELEVANT LINKS:

See HR Reference Manual, [Chapter 6](#), for more information on negotiating wages and benefits.

[Minn. Stat. § 471.6161, subd. 5.](#)

### **g. Total compensation statements**

It's very common for personnel costs to consume 60 to 70 percent of a city's budget. With this significant expense, some cities find value in implementing total compensation benefit statements for their employees.

Total compensation benefit statements often include the employee's salary and the value of the employer contribution to health care, retirement, and time off as well as other benefits.

### **B. Other types of pay increases/issues**

It is important to note no additional compensation or benefits can be offered to a union employee without negotiating it. The union is the exclusive bargaining representative for wages and terms and conditions. It cannot be bypassed on wage or benefits issues regardless of how innocuous or beneficial to the employee.

Additionally, keep in mind under Minnesota law, the city cannot *reduce* the value of group insurance benefits for employees covered by a collective bargaining (union) agreement without the agreement of the union. This may mean, in some cases, the city cannot increase the co-payments of their health insurance plan or increase the deductible without the agreement of the union.

#### **1. Retention increases**

A retention increase is usually given to an employee to retain the employee when he/she has a job offer with another employer at a higher salary. Retention increases tend to be used more in the private sector than in the public sector. Often public sector pay plans do not have the flexibility to award retention increases, or in some situations, they may only be awarded by the city council. Waiting for city council approval for a retention increase may not be practical when an employee has another job offer waiting.

Building the ability to award retention increases into a pay plan can be advantageous in some situations. For example, if an employee is critical to the functioning of a team, a department, or the city in general, and if the only reason for the employee to be seeking other employment is his salary, a retention increase may be a good solution.

However, retention increases cannot be routinely given out without undermining the integrity of the pay plan.

## RELEVANT LINKS:

In addition, cities should be careful to ensure uniform treatment of employees based on business needs and avoid decisions that may lead to a disparate impact that could be found discriminatory. For example, males are regularly offered retention increases and females are not.

Also, there are often many reasons beyond just salary for an employee to seek another job. Persuading an employee to stay for more money when they are unhappy with other aspects of the employment may just result in a less happy, less productive employee in the long run who, unfortunately, feels trapped because of the amount of money he or she is earning.

Therefore, while having the ability to award retention increases may be a helpful tool, it should be used relatively rarely. A better approach is for the city to make efforts to maintain a pay plan that reflects the market rates for each position. See Maintaining a Compensation Plan below for more information.

## 2. Red-circled salaries

A red-circled salary refers to a situation where an employee is being paid a rate higher than the maximum of the salary grade assigned to that position. This occurs occasionally when there are labor shortages associated with a particular job class, such as city engineers or nurses, and the city is forced to pay a higher rate in order to recruit qualified candidates for the job.

Generally, the employee is treated in the same manner as other employees who are at the top of the salary grade (e.g., eligible for cost-of-living increases but no other types of pay increases until the salary range “catches up”). However, sometimes the employee’s salary is completely frozen; e.g., absolutely no salary increases are given until the salary range again exceeds the employee’s wage rate.

## 3. Out-of-class pay

Sometimes, either by union contract or city policy, a city pays an employee for working outside of his or her job class. For example, a light equipment operator might be paid a premium rate of pay when he or she is asked to operate certain types of equipment generally assigned only to heavy equipment operators. Another example occurs if a manager or supervisor is absent for several months and another employee is asked to “fill in.” Sometimes the city will assign the employee to a higher salary grade temporarily, increase his or her pay by a certain percentage, or somehow financially reward the employee for performing the additional, higher-level work.

## RELEVANT LINKS:

U.S. Dep't of Labor:  
[Consumer Price Index](#).

U.S. Dep't of Labor:  
[Consumer Price Index](#)  
[FAQ's](#).

Generally, employees are only given additional pay for working “out of class” when they are asked to take on higher-level duties than they usually perform, but some cities give additional pay when an employee is asked to assume substantially larger workloads than usual, especially if the employee doesn’t receive overtime for the additional hours.

### 4. Across-the-board or cost-of-living increases

In some situations, employees receive across-the-board wage adjustments based on some factor such as cost-of-living increases. There is no state or federal law requiring the city to give cost of living increases to its employees, but they are usually given in situations such as the following:

- When an employee is paid at a set wage rate (usually an hourly rate) with no assigned salary range.
- When negotiated for all employees covered by a collective bargaining agreement (union agreement), or a personnel ordinance or policy provision.
- When an employee is paid at the maximum of the assigned salary range.
- When an employee is occupying a seasonal or temporary job.
- To keep up with what other employers are paying for similar job duties, to avoid low employee morale/productivity, high turnover, and/or difficulty in recruiting.

If the city wishes to tie across-the-board wage increases to a specific cost-of-living type factor, it’s a good practice to select one and use it consistently from year to year. Many employers use the Consumer Price Index (CPI) established by the Bureau of Labor Statistics (BLS). The CPI is the most widely used measure of inflation (how much more goods and services cost today versus in the past).

The CPI reflects spending patterns for each of two population groups: all urban consumers, and urban wage earners and clerical workers. The all urban consumers group represents about 87 percent of the total U.S. population. It is based on the expenditures of almost all residents of urban or metropolitan areas, including professionals, the self-employed, the poor, the unemployed, and retired persons as well as urban wage earners and clerical workers. Not included in the CPI are the spending patterns of persons living in rural nonmetropolitan areas, farm families, persons in the Armed Forces, and those in institutions such as prisons and mental hospitals. The price change experience of the all urban consumer group is measured by two indexes, namely the traditional Consumer Price Index for All Urban Consumers (CPI-U) and the newer Chained Consumer Price Index for All Urban Consumers (C-CPI-U).

## RELEVANT LINKS:

[29 U.S.C. ch. 8.](#)

[Minn. Stat. § 177.23, subd. 6.](#)  
HR Reference Manual,  
Chapter 1.

[Minn. Stat. § 177.24.](#)  
HR Reference Manual,  
Chapter 1.

The consumer price index for Urban Wage Earners and Clerical Workers (CPI-W) is based on the expenditures of households included in the CPI-U definition that also meet two requirements:

- More than one half of the household's income must come from clerical or wage occupations and at least one of the household's earners must have been employed for at least 37 weeks during the previous 12 months. The CPI-W's population represents about 32 percent of the total U.S. population and is a subset, or part, of the CPI-U's population.
- In addition to the national data, BLS publishes a CPI-U, C-CPI-U, and CPI-W for the Minneapolis-St. Paul metropolitan area twice per year.

Cities also sometimes use the CPI to make decisions about how much to adjust salary grades. See the section below on Maintaining a Compensation Plan.

## 5. Maintaining a compensation plan

A compensation plan will deteriorate over time if it is not maintained. In other words, a city cannot establish salary grades for each job class and expect them to remain valid forever. Market rates for various jobs change greatly over time due to changes in the labor market. For example, in recent years cities have reported having trouble hiring civil engineers and finance staff. These factors drive up market rates for high-demand job classes.

Also, since most employers adjust wages from time to time to protect employees from inflation and to reward high-producers, the overall rates for all job classes usually increase over time. For these reasons, many employers adjust their own salary grades by some factor each year.

## C. Minimum wage and overtime laws

Cities are covered by both the federal Fair Labor Standards Act (FLSA) and the Minnesota Fair Labor Standards Act and are generally required to comply with the law that is least restrictive (i.e., more generous to employees).

### 1. Minimum wage—state law

Effective August 1, 2014, the Minnesota Fair Labor Standards Act increased the state minimum wage with yearly wage increases for the next few years and adjusted the definition of “large employer.”

## RELEVANT LINKS:

[Minn. Stat. § 177.24, subd. 1\(2\)\(e\).](#)

[Minn. Stat. § 177.24, subd. 1\(2\)\(c\).](#)

MN Dep't of Labor and Industry: [Minimum wage rate adjusted for inflation as of Jan. 1, 2018.](#)

[Minn. Stat. § 177.24.](#)

[Minn. Stat. § 177.23, subd. 7\(5\).](#)

[Minn. Stat. § 177.23, subd. 7\(6\).](#)

[Minn. Stat. § 177.23, subd. 7\(7\).](#)

[Minn. Stat. § 353.01 Subd. 2b \(a\) \(9\) \(i\)](#)

Effective Jan. 1, 2018, Minnesota's minimum wage will increase to \$9.65 per hour for large employers (up from \$9.50 per hour), and to at least \$7.87 per hour for small employers (up from \$7.75 per hour). Both of these rates will be adjusted for inflation at a rate to be determined by the commissioner of the Department of Labor and Industry by and announced by Aug. 31 annually. For additional information on Minnesota's minimum wage law, please refer to the City Employment Basics Chapter linked to the left.

## 2. Exemptions from state law

There are two exceptions to these wage amounts for younger employees.

### a. Youth Wage

As of Jan. 1, 2018, both large and small employers must pay employees under age 18 at least \$7.87 per hour (an increase from \$7.75/hour).

Since small employers must pay at least \$7.87 per hour to all employees as of January 1, 2018, the youth wage rate does not allow small employers to pay employees under the age of 18 less than that \$7.87/hour minimum.

### b. Ninety-day training wage

The "training wage," as of January 1, 2018, allows large employers to choose to pay employees under age 20 a "90-day training wage" of at least \$7.87 per hour, but only for the first 90 consecutive days of employment. Importantly, once the 90-day period is up, large employers must increase those wages to \$9.65 per hour. Since small employers must already pay at least \$7.87 per hour to all employees as of January 1, 2018, so this 90-day training wage exemption does not apply.

Additionally, the state's minimum wage law does not cover certain positions. Below is a listing of those positions not covered by the minimum wage law that are most likely to occur in cities:

- Any staff member employed on a seasonal basis for work in an organized resident or day camp operating under a permit issued under Minn. Stat. § 144.72.
- Individuals employed in a bona fide executive, administrative, or professional capacity.
- Any individual who renders service gratuitously for a nonprofit organization.
- Student interns, as defined in the law

## RELEVANT LINKS:

[Minn. Stat. § 177.23, subd. 7\(8\).](#)

[Minn. Stat. § 177.23, subd. 7\(9\).](#)

[Minn. Stat. § 177.23, subd. 7\(14\).](#)

[Minn. Stat. § 177.23, subd. 7\(10\).](#)

[Minn. Stat. § 353.01 Subd. 2b \(a\) \(19\).](#)

[Minn. Stat. § 353.01 Subd. 2b \(a\) \(1\).](#)

[Minn. Stat. § 353.01 Subd. 2b \(a\) \(9\) \(ii\).](#)

[29 U.S.C. § 206.](#) U.S. Dep't of Labor: [Minimum Wage.](#)  
U.S. Dep't of Labor: [Compliance Assistance - Wages FLSA.](#)

[29 U.S.C. § 206\(g\)\(1\).](#)  
U.S. Dep't of Labor: [Question and Answer about minimum wage.](#)  
U.S. Dep't of Labor: [Fact Sheet #32: Youth Minimum Wage - Fair Labor Standards Act.](#)

[29 U.S.C. § 206\(g\)\(1\).](#)

U.S. Dep't of Labor, [Youth Minimum Wage Program.](#)

U.S. Dept. of Labor: [FLSA what is minimum wage.](#)

- Elected officials and board, commission, or committee members of a political subdivision.
- Police and fire employees employed by a political subdivision or employed by an entity whose principal purpose is to provide police and fire protection to a political subdivision.
- Individuals under 18 working less than 20 hours per week for a municipality as part of a recreation program.
- Certain employees ineligible for PERA coverage as follows:
  - Employees in seasonal positions expected to last less than 185 consecutive calendar days.
  - Employees in temporary positions expected to last less than six months.
  - Those whose annual salary from one governmental subdivision never exceeds \$5,100 stipulated in writing in advance.
  - Resident physicians, medical interns, and pharmacist residents and pharmacist interns serving in a degree or residency program in public hospitals.

### 3. Minimum wage—federal law

Effective July 24, 2009, federal law requires employers pay a minimum wage of at least \$7.25 per hour.

However, workers under age 20 may be paid at the rate of \$4.25 per hour during their first 90 consecutive days of employment with a city, as long as their work does not displace other workers. Again, it is important for cities to be mindful as employers they are covered by both the federal Fair Labor Standards Act (FLSA) and the Minnesota Fair Labor Standards Act, and are generally required to comply with the law that is least restrictive (i.e., more generous to employees).

It is important to note the Department of Labor states the eligibility period runs for 90 consecutive calendar days beginning with the first day of work for an employer. The Department of Labor also states, it does not matter when the job offer was made or accepted (or when the employee was considered "hired"). The 90-day period starts with (and includes) the first day of work for the employer. The 90-day period is counted as consecutive days on the calendar, not days of work. It does not matter how many days during this period the youth actually performs any work.

After the first 90 days or when the employee reaches age 20, whichever comes first, he or she must receive the normal minimum wage of \$7.25 per hour.

## RELEVANT LINKS:

[29 U.S.C. § 214.](#)  
U.S. Dept. of Labor: [FLSA Full-Time Student Program](#) for information on this program and how to apply for a certificate.

U.S. Dep't of Labor: [FLSA Workers with Disabilities](#) for information on this program and how to apply for a certificate.

[Minn. Stat. § 177.253.](#)

[Minn. Stat. § 177.254.](#)

[Minn. Stat. § 177.254, subd. 2.](#)

[Minn. Stat. § 181.101.](#)

LMC information memo, [Paychecks](#).

High school students at least 16 years old enrolled in vocational education can be paid at a rate not less than 85 percent of the minimum wage for as long as the student is enrolled in the vocational education program. The employer must apply for a student learner certificate with the Department of Labor Wage and Hour regional office in Chicago, Illinois.

Workers with disabilities may be paid at special minimum wage rates after the city obtains a certificate from the Wage and Hour Division of the Department of Labor. However, the disability must actually impair the worker's earning or productive capacity for the work being performed. A disability in and of itself is not sufficient to warrant inclusion in this program. Because employees must be given the benefits associated with the more generous of the two wage and hour laws (federal and state), cities should carefully review the provisions of both laws before determining the minimum wage for any given classification of employee.

## D. Breaks and meal periods

### 1. Mandatory work breaks

An employer must allow employees adequate time away from work to utilize restroom facilities at least every four hours.

The city can negotiate a different arrangement for rest breaks under a collective bargaining agreement with union employees.

### 2. Mandatory meal breaks

An employer must give employees who work for eight or more consecutive hours sufficient time to eat a meal. The law does not require this to be paid time. The city may want to consider encouraging its employees to take such breaks for both safety and productivity reasons.

An employer can make a different arrangement for meal periods under a collective bargaining agreement with union employees.

## E. Payroll issues

### 1. Pay periods

Generally, cities must pay all wages earned by an employee at least once every 31 days on a regular payday designated in advance by the city. This is true even if the employee agrees to or requests payment at longer intervals. Unless paid earlier, the wages earned during the first half of the first 31-day pay period are due on the first regular payday following the first day of work.



## RELEVANT LINKS:

[2015 Minn. Laws ch. 65, § 181.101.](#)

[Minn. Stat. § 181.032.](#)  
LMC information memo,  
*Paychecks.*

[Minn. Stat. § 181.01.](#)

[Minn. Stat. § 181.13.](#)

[Minn. Stat. § 181.13.](#)

[Minn. Stat. § 181.13 \(b\).](#)

[Minn. Stat. § 181.13.](#)

[Minn. Stat. § 181.14.](#)

There is an exception for volunteer firefighters, first responders, volunteer ambulance drivers and attendants. Effective May 23, 2015, this specific group of employees may be paid at longer intervals than once every 31 days, provided the employer and employee mutually agree to the arrangement.

The Commission of Labor and Industry has the right to demand payment on behalf of an employee and can charge and collect the wages earned plus penalties if the wages are not paid within 10 days of demand. Wages are considered earned on the day worked.

At the end of each pay period, the city must give the employee an earnings statement in writing or by electronic means covering that pay period. For additional information regarding the earnings statement, please refer to the Paychecks memo linked to the left.

## 2. Wages of minors

A parent or guardian may claim the wages of a minor if they notify the city, but if they fail to do so, the city can make payment to the minor.

## 3. Wages due at discharge

When the city discharges an employee, all wages are due and payable upon written demand of the employee.

If the wages are not paid within 24 hours after demand, the employer is in default and subject to penalties. However, for cities requiring city council approval of expenditures, the 24-hour period doesn't begin until the date of the first regular or special meeting following the discharge of the employee.

The final paycheck due upon discharge of an employee must be paid in the usual manner unless the employee requests that it be mailed. In that case, the wages are considered paid as of the date of the postmark.

An employee may recover an additional amount equal to the unpaid wages as compensatory damages.

## 4. Wages due at resignation

The city must pay the wages due to an employee who quits or resigns on the first regularly scheduled payday following the final day of employment unless there is a different provision in the employee's union contract.

## RELEVANT LINKS:

[Minn. Stat. § 181.14, subd. 2.](#)

If the first regularly scheduled payday is less than five calendar days following the final day of employment, the last paycheck can be delayed until the second regularly scheduled payday but must be paid within 20 calendar days following the final day of employment.

[Minn. Stat. § 181.14, subd. 5.](#)

If the wages are not paid within the required timeframe after resignation, they become payable upon written demand. If the wages are not paid within 24 hours after demand, the employer is subject to penalties. Cities are also prohibited from making any employee deductions from wages due or earned unless specifically authorized.

[Minn. Stat. § 181.14, subd. 3.](#)

The final paycheck due upon resignation of an employee must be paid in the usual manner unless the employee requests that it be mailed. In that case, the wages are considered paid as of the date of the postmark.

## 5. Settlement of disputes

Cities are potentially subject to interest and legal fees when the amount of an employee's final paycheck is in dispute and the employee wins in court.

[Minn. Stat. § 181.14, subd. 4.](#)

## 6. Employees entrusted with money or property—final paycheck

In cases where an employee entrusted with money or property quits or is discharged, the city has 10 calendar days to audit the accounts of the employee before paying the employee's wages. Penalties for late payment of the final paycheck will only apply to a demand made after the 10-day period.

[Minn. Stat. § 181.14, subd. 1.](#)

No employer shall make any deduction, directly or indirectly, from the wages due or earned by any employee, who is not an independent contractor, for lost or stolen property, damage to property, or to recover any other claimed indebtedness running from employee to employer, except as permitted by Minn. Stat. § 181.79.

[Minn. Stat. § 181.15.](#)

## 7. Employees on strike or refusing payment of final paycheck

An employee who stays away to avoid payment or refuses payment of a final paycheck is not covered by the provisions of Minnesota statutes that require prompt payment of the final paycheck. However, striking employees are entitled to receive their final pre-strike paycheck on the next regular payday after the strike begins.

## RELEVANT LINKS:

[Minn. Stat. § 181.06.](#)  
LMC information memo,  
[Paychecks.](#)

[Minn. Stat. § 177.24, subd. 4.](#)  
LMC information memo,  
[Paychecks.](#)

[Minn. Stat. § 181.06, subd. 2.](#)

[Minn. Stat. § 352.965, subd. 2.](#)

## 8. Withholdings and deductions

### a. Deductions authorized by law

If authorized by the employee in writing, the city can make certain types of payroll deductions. For additional information on these deductions, refer to the Paychecks memo linked to the left.

### b. Uniforms and equipment

In addition, the city can make deductions for the cost of uniforms and equipment as follows, but the deductions cannot result in wages being paid below the minimum wage. For additional information regarding uniforms and equipment deductions, please refer to the Paychecks Memo linked to the left.

### c. Charitable deductions

Many cities choose to participate in some type of annual charitable fund drive such as United Way.

The law allows cities to make deductions for this purpose; however, the city may choose to limit the number of charitable organizations for which employees can use charitable payroll deductions.

Having too many different types of organizations may cause undue administrative burden for cities (e.g., all funds collected have to be accounted for and distributed to the charitable organizations).

One best practice in this area is to limit the number of charitable organizations, develop criteria for inclusion, and refer requests to an employee committee to the city council or to a personnel committee for review.

### d. Employee-requested deductions

From time to time, employees may request the city establish a payroll deduction that is not currently being offered. Occasionally, there may be a law requiring the city to comply with the employee's request. For example, the city must comply with any employee request to offer payroll deduction for the state's deferred compensation plan. However, for the most part, whether to allow a specific payroll deduction is the city's decision.

## RELEVANT LINKS:

[Minn. Stat. ch. 353.](#)  
[Minn. Stat. § 353.01.](#)  
HR Reference Manual,  
Chapter 1.

See generally [Minn. Stat. ch. 571.](#)

[Minn. Stat. § 571.77.](#)

[31 U.S.C. § 3720D.](#)

The city should evaluate each request carefully to ensure legal compliance, but also take into consideration that too many different types of payroll deductions can create an administrative burden for the city and its finance department.

### **e. Public Employees Retirement Association**

Participation in the Public Employees Retirement Association (PERA) is mandatory for all covered city employees. Volunteer firefighters and election officers are generally not covered; most other employees are. Participation for local elected officials is voluntary. For additional information on PERA as well as other public employee pension plans and deferred compensation plans, refer to the Employment Basic chapter of the HRRM.

### **f. Garnishments**

A garnishment is an order from a court or a governmental agency for an employer to withhold money from an employee's paycheck for a specified debt such as child support or payment of past due taxes. Garnishments come from sources such as the Internal Revenue Service (IRS), state and federal agencies and courts, or from an individual creditor.

A city should never ignore a garnishment order because the city could become liable for the amount of the debt. However, the city may want to consult an attorney before withholding the amounts, especially if there are multiple garnishments from various sources.

Cities should be aware that:

- Both federal and state law establish maximum levels of garnishment and these can vary depending on the type of garnishment (e.g., child support vs. delinquent taxes vs. other creditors).
- It may be illegal to discriminate against or discharge employees on the basis of garnishment—cities should consult with an attorney before taking any employment action, especially discharge, on this basis.
- Both federal and state laws establish a priority order for garnishments based on the type of debt. Child support orders take first priority under both state and federal laws.

Federal laws in this area are complex and interact with each other and with state laws. Some of the major federal laws that could be involved in a garnishment order include the following:

- Debt Collection Improvement Act of 1996 (Public Law 104-134)

## RELEVANT LINKS:

U.S. Dep't of Labor:  
[Consumer Credit Protection Act.](#)

[11 U.S.C. § 547.](#)

[25 U.S.C. § 6331.](#)

[42 U.S.C. § 654\(20\)\(A\).](#)  
[Minn. Stat. ch. 518C.](#)

[20 U.S.C. § 1095a.](#)  
U.S. Dep't of Labor: [Fact Sheet #30: The Federal Wage Garnishment Law, Consumer Credit Protection Act's Title 3 \(CCPA\).](#)

MN Dep't of Human Services, [New Hire Reporting Center.](#)  
[Minn. Stat. ch. 518.](#)  
[Minn. Stat. ch. 571.](#)  
[Minn. Stat. § 181.79, subd. 1 \(b\).](#)

[Minn. Stat. § 256.998.](#)

[Minn. Stat. § 518A.41.](#)

[Form W-4, Employee's Withholding Allowance Certificate, 2013.](#)

- Consumer Credit Protection Act
- Bankruptcy Code
- Internal Revenue Code
- Uniform Interstate Family Support Act of 1996
- Higher Education Act/Administrative Wage Garnishment Act

In addition to the federal laws that could come into play, there are several state laws:

- Child Support Orders (Minn. Stat. ch. 518).
- Garnishment (Minn. Stat. ch. 571).

Minnesota employers, including cities, are required to report new hires (including independent contractors) to the New Hire Reporting Center within 20 days.

Employers are not required to report the hiring of any person who will be employed for less than two months' duration and will have gross earnings less than \$250 per month. This may identify your employee as having a child support order and the city may be required to take appropriate deductions.

If a child support order includes a requirement to provide health insurance and dependent coverage if available, then the city must make the coverage available. If the city willfully fails to comply with the order to provide coverage, the city may be found liable for the health or dental expenses incurred by the dependents during the period of time the dependents were eligible to be enrolled.

## 9. Taxes

### a. State and federal withholding

Cities are required to withhold taxes from the pay of their employees for federal and state income tax.

## RELEVANT LINKS:

IRS, Tax Topic 753, [Form W-4 Employee's Withholding Allowance Certificate](#).

IRS website information: [Hiring Employees](#).

IRS Publication 15, Circular E, Employer's Tax Guide 2017.

IRS Publication 15, Circular E, Employer's Tax Guide 2017, Recordkeeping section.

IRS: [Withholding Calculator](#).

Minnesota Department of Revenue, Form MWR, Reciprocity Exemption / Affidavit of Residency for Tax Year 2015.

IRS Publication 15, Circular E, Employer's Tax Guide 2017, Fringe benefit exclusion rules section.

The amount of tax withheld is based on the information provided by the employee on IRS Form W-4 using the withholding tables published by the IRS or by the State of Minnesota Department of Revenue. If a new employee does not provide this information, taxes are withheld as if he or she is single with no withholding allowances. An employee's W-4 remains in effect until the employee gives the city a new one.

If an employee gives the city a new W-4, the city should begin withholding no later than the start of the first payroll period ending on or after the 30th day from the date when the new W-4 was received. There is no limit on the number of times an employee may change the number of withholding exemptions by filing a new W-4, and cities cannot charge a fee for processing a revised W-4.

After the employee completes and signs the Form W-4, the city must retain it for at least 4 years. This form serves as verification that the city is withholding federal income tax according to the employee's instructions and needs to be available for inspection should the IRS ever request it.

Employees who are unsure about how much to withhold can use the IRS website's Withholding Calculator. The amount of any withholding must be based on marital status and withholding allowances. Employees may not base their withholding amounts on a fixed dollar amount or percentage. However, an employee may specify a dollar amount to be withheld in addition to the amount of withholding based on filing status and withholding allowances claimed on Form W-4.

Employees may claim fewer withholding allowances than they are entitled to and may wish to do so to make sure they have enough withholding or to offset tax on other sources of taxable income.

Withholding applies to wages of residents of Minnesota and nonresidents for income earned in Minnesota. However, residents of Michigan, North Dakota, and Wisconsin can file a form MWR with the city by February 28 of each year or within 30 days after they begin working for a city or change their residence in order to avoid Minnesota withholding.

If an employee does not fill in every item of Form MWR, the city must withhold Minnesota income tax using the same marital status and number of allowances claimed on the employee's federal Form W-4.

Generally, employees who are subject to federal withholding are also subject to state income tax withholding. Withholding applies to all payments given to an employee for services performed including severance, vacation and sick leave payouts, and certain fringe benefits.

## RELEVANT LINKS:

[MN Dep't of Revenue, Withholding Fact Sheet 9, Definition of Wages. Minnesota Income Tax Withholding Instruction Booklet and Tax Tables.](#)

[PERA Employer Manual: Defined Benefit Plans.](#)

[IRS: Publication 15: \(Circular E\) Employer's Tax Guide.](#)

[IRS: Quick Reference Guide For Public Employers, February 2014. MN Revenue.](#)

[LMC Social Security and Medicare Chart.](#)

[Social Security Administration Publ. 05-1007, June 2012. "Government Pension Offset".](#)

[Social Security Administration: State and Local Government Employers Information.](#)

[Social Security Form 1945.](#)

Compensation subject to federal withholding normally is also subject to state withholding. Income not subject to withholding includes the following:

- Employee contributions to the Public Employees Retirement Association. (However, these contributions are still subject to Social Security and Medicare withholding. Please note members of the Police and Fire PERA do not have Social Security tax withheld from their wages, although employees hired after March 31, 1986, do have Medicare contributions withheld).
- Employee contributions to group insurance premiums (usually health and dental) that are part of an established cafeteria plan.
- Employee contributions to flexible spending accounts for dependent care or medical care.
- Employee contributions to any deferred compensation (but still subject to Social Security and Medicare).
- Employee contributions to post-employment health care savings accounts.

Both the IRS and the Minnesota Department of Revenue have extensive information for employers on withholding on their websites.

## b. Social security and Medicare

Requirements for employee and city contributions to Social Security and Medicare vary according to different categories of public employees, based primarily on their participation in a specific retirement plan.

This may or may not include elected officials, depending on several factors, including what retirement plan option the elected official has chosen. Follow the link to the left for a chart which shows the general requirements for various groups of city employees.

The Social Security Protection Act of 2004 requires state and local government employers to disclose the effect of the Windfall Elimination Provision and the Government Pension Offset to employees hired on or after January 1, 2005, in jobs not covered by Social Security.

The law requires certain newly hired public employees to sign a statement that they are aware of a possible reduction in their future Social Security benefit entitlement.

A copy of the signed form is to be forwarded to the retirement system that will provide benefits to the employee upon retirement (i.e., PERA). The disclosure form is included in the link to the left.



## RELEVANT LINKS:

MN Revenue: [E-Services](#).  
[IRS Form 941](#), Employer's  
Quarterly Federal Tax  
Return.  
[IRS: Form 941 for 2017](#).  
MN Unemployment  
Insurance: [Employer Self  
Service](#).  
PERA: [Employer Reporting  
and Information System  
\(ERIS\)](#).

ICMA: [EZlink](#).

Social Security Online:  
[Filing w-2s electronically](#).  
MN Unemployment  
Insurance: [Employer Self  
Service](#).

[Minn. Stat. § 471.426](#).

[Minn. Stat. § 177.30](#).

The laws surrounding Social Security and Medicare withholdings are complex and can change over time. Cities should call the League or the Public Employees Retirement Association (PERA) for additional assistance if they are unsure about how to handle a particular group of employees.

## 10. Reports

All cities with employees are required to submit the following payroll reports:

- A quarterly report to the Minnesota Department of Revenue (and possibly other states in which employees reside and have completed a reciprocity exemption form such as North Dakota, or Michigan) showing wages paid, number of employees, income taxes withheld, and tax deposits.
- A quarterly report, Form 941, to the Internal Revenue Service (IRS) showing the number of employees, wages paid, federal income taxes withheld, Social Security and Medicare taxes withheld, various adjustments, advance earned income credit, and total deposits.
- A quarterly report (filed online) for the Minnesota Department of Economic Security showing wages paid and other information for each employee.
- A report to the Public Employees Retirement Association (PERA) each pay period showing the amounts withheld by employee and the employer contribution, in addition to other information.
- A report to any deferred compensation providers (the Minnesota State Retirement System plan, ICMA, etc.) each pay period showing the contributions withheld by employee.
- An annual report to the Social Security Administration and the Minnesota Department of Revenue showing the W-2 information for all employees as well as the actual W-2 reports to be given to each employee.

## 11. Direct deposit

Many cities prefer their employees use direct deposit rather than issuing payroll checks. State law allows cities to mandate direct deposit for city employees. As with any change in employment policy, it is a good practice to discuss the change with employees in advance and work with them on any major impacts.

## 12. Recordkeeping, required posting and penalties

Under state law, all cities must keep records of the following:



## RELEVANT LINKS:

[Minn. Stat. § 177.30, subd. 5.](#)

[Minn. Stat. § 177.30, subd. 5\(b\).](#)

[MN Dep't. of Labor and Industry, Mandatory workplace posters.](#)

[U.S. Dept. of Labor, Posters.](#)

[U.S. Equal Employment Opportunity Commission EEOC Poster Request Form.](#)

[Minn. Stat. § 471.701.](#)

[Minn. Stat. § 471.701.](#)

[Minn. Stat. § 177.32.](#)

- The name, address, and occupation of each employee.
- The rate of pay and the amount paid each pay period to each employee.
- The hours worked each day and each workweek by the employee.
- Other information necessary to verify that the city is complying with the state's minimum wage and overtime laws.

These records must be kept in or near the premises where an employee works and retained for three years. The Minnesota Department of Labor and Industry (DOLI) may fine a city up to \$1,000 for each failure to maintain records as required by this statute, in addition to other penalties and fines that may be imposed on cities for violating the state's minimum wage/overtime laws.

Minnesota and federal law requires employers to display mandated posters in a physical location where employees can easily see them. These postings are available to the city at no charge from the Equal Employment Opportunity Commission (EEOC), U.S. Department of Labor, and MN Department of Labor and Industry (DOLI) websites. Cities can be fined for failure to display these required postings.

Cities with a population of more than 15,000 population must annually notify residents of the positions and base salaries of its three highest paid positions. Generally, the city should not consider overtime in determining which positions are the three highest paid for purposes of complying with this requirement.

The statute refers to base salary, so additional compensation such as overtime, which can vary from year to year, should probably not be considered.

Cities can fulfill this requirement by doing one of the following: 1) posting the information on the home page of the city's website for at least ninety consecutive days; 2) including the information in a city publication that is distributed to all residents; or 3) including the information in the annual notice of proposed property taxes.

The city is guilty of a misdemeanor for any of the following:

- Hindering or delaying DOLI in enforcement of the minimum wage/overtime laws.
- Refusing to allow DOLI to enter city offices and examine the city's records.
- Repeatedly failing to make, keep, and preserve required records.
- Falsifying any record.
- Repeatedly failing to display the required postings.
- Failing to pay minimum wage or required overtime.

**RELEVANT LINKS:**

[Minn. Stat. § 177.32, subd. 2.](#)

- Refusing to allow required rest breaks (adequate time to use restroom facilities at least every four hours).

The city can be fined between \$700 and \$3,000 for discharging or discriminating against any employee because the employee did one of the following:

- Complained that wages have not been paid correctly under the state wage/overtime laws.
- Initiated a proceeding against the city for violations of the state wage/overtime laws.
- Testified in a proceeding against the city for violations of the state wage/overtime laws.

## **New Ulm, MN's performance incentive program**

New Ulm's performance incentive program is exclusively meant for their exempt employees. The evaluation, and subsequent payment (or lack thereof) takes place at the end of the year. To avoid problems with Minnesota statute, they base their incentive payments on specific measures. Employees are rated at year's end on goals/objectives and job success factors that are set at the beginning of the year. Based upon an employee's score, he/she would receive \$0, \$500, or \$1000 in an additional lump sum payment. Below is a breakdown/example of how New Ulm scores their incentive pay-eligible employees, and the corresponding bonus structure for which he/she would then qualify.

### **Example of 2018 Scoring:**

#### **Goals/Objectives**

***Does Not Meet = 0 points / 1 point / Partially Meets = 2 points / 3 points / Meets = 4 points***

<b>Goals/Objective</b>	<b>Rating</b>
Goal #1	3
Goal #2	2
Goal #3	4
<b>TOTAL</b>	<b>9</b>

*Multiply the total score by 3*

**TOTAL RATING = 27**

#### **Job Success Factors – Weight – 16.666% Each**

***Does Not Meet = 0 points / 1 point / Meets = 2 points / 3 points / Exceeds = 4 points / 5 points / Exceptional = 6 points***

<b>Job Success Factor</b>	<b>Rating</b>
Priority Setting	3
Building Effective Teams	2
Directing Others	4
Organizing	5
Informing	1
Self-Knowledge	4
<b>TOTAL</b>	<b>19</b>

**Overall Rating (TOTAL): 27 + 19 = 46 (Out of a Possible 72 Points)**

**Performance Pay:**

**\$0 – Rating of 23 or less**

**\$500 – Rating of 24 – 41**

**\$1000 – Rating of 42 or higher**