

Compensation Conundrum

A conundrum: something that is puzzling or confusing. Not always the case for compensation as we tend to resort to benchmarking to see how others approach the puzzle. This is a periodic view of some common conundrums faced by HR and compensation practitioners.

What happens when a nonexempt employee becomes exempt? First, what are the specific considerations? Overtime? Bonus plan target? Differentials? Generally anything that falls into a W-2 at the end of the year seems to be up for debate. Three alternatives include:

1. ***Gross them up.*** Take last year's W-2 earnings, add to base pay and use that as a starting point for the new salary. Advantages: removes the "I'm taking a pay cut" discussion off the table. Disadvantages: may create inequities in the new job classification; may mar the "shine" of the promotion if salary adjustment isn't perceived as significant; may create the entitlement for future employee movements; creates a new higher annuity for base pay unrelated to your pay philosophy or strategy; implies that the overtime was a fixed part of pay, not variable.
2. ***Buy them out.*** Come up with an amount – doesn't have to directly relate to overtime or other pay – that is essentially a sign-on bonus. And then make the appropriate adjustment to base salary to land within the new pay range. Advantages: better manages the internal equity in the new job; doesn't set any entitlement of a specific salary treatment; eliminates the annuity of folding other compensation into new base pay. Disadvantages: hits cash flow; employee could quit and leave with the lump sum; higher taxes to employee.
3. ***Ignore the issue.*** Usually a move from a nonexempt to an exempt role means the employee is getting into a job with greater advancement potential and pay opportunity so should be viewed as a long-term investment to the employee, not a short-term change in cash flow. Advantages: maintains the integrity of your salary structures; gives more credibility to career development; any promotional increase is more meaningful as to the change in responsibilities. Disadvantages: employee perceptions every two weeks or so when their paycheck doesn't go quite as far; potential short-term disengagement as their inputs increase/change and in their opinion, pay doesn't reflect the increased responsibility.

Compensation & Rewards



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If you have a lot of employee movement like this, you might also have exempt to nonexempt movement too. In that case, think not only of how to unwind what you do, look at your salary structures too – midpoint differentials, pay range spreads and the like. Those design decisions become more important in that case.