



## Pay systems

### Introduction

Pay is a key factor affecting relationships at work. The level and distribution of pay and benefits can have a considerable effect on the efficiency of any organisation, and on the morale and productivity of the workforce. It is therefore vital that organisations develop pay systems that are appropriate for them, that provide value for money, and that reward workers fairly for the work they perform.

Pay systems are methods of rewarding people for their contribution to the organisation. Ideally, systems should be clear and simple to follow so that workers can easily know how they are affected.

In considering rewards it should be borne in mind that pay and financial benefits are not the only motivator for worker performance. Other important motivators for individuals may include job security, the intrinsic satisfaction in the job itself, recognition that they are doing their job well, and suitable training to enable them to develop potential.

## What are pay systems?

Key Points: -

Pay systems provide the foundation for financial reward systems

There are basic rate systems, where the worker receives a fixed rate per hour/week/month with no additional payment

There are systems related in whole or part to individual or group performance or profit

There are systems based in part on the worker gaining and using additional skills or competencies

Pay systems provide the bases on which an organisation rewards workers for their individual contribution, skill and performance.

Pay structures are different - they are used to determine specific pay rates for particular jobs, usually based on the nature of the job, its content and requirements. A pay structure provides the framework within which the organisation places the pay rates for its various jobs or groups of jobs.

Pay systems fall into two main categories:

- those where pay does not vary in relation to achievements or performance, (basic rate systems), and
- those where pay, or part pay, does vary in relation to results/profits/performance (including the acquisition of skills).

There are also systems where pay, and any enhancement, is related to the gaining of extra skills or competencies. These systems can provide opportunities for greater job satisfaction - allowing workers to carry out a wider range of work, or work at a higher level.

Basic rate systems are the easiest to operate, and apply to many workers in the UK. The worker receives a fixed rate per hour, week or month.

Substantial numbers of workers however, have part (though generally not all) of their pay based on incentive, or variable, systems. Their earnings can therefore vary according to their own performance, that of their team or group, or perhaps that of the enterprise as a whole.

Relativities and pay differentials between individuals or groups of workers are, of course, also of fundamental importance. These are generally determined by the wage or salary structure of the organisation, rather than by the pay system, but they may be affected by changes in the pay system.

The selection of an organisation's pay system is often determined by negotiations between management and worker representatives. In theory these negotiations can be kept quite separate from negotiations over payment structures and levels or amounts of pay; but in practice negotiations often embrace all pay-related issues.

## Why have different types of pay systems?

Key Points: -

- Basic rate schemes, while clear, may not offer incentives for increased or improved performance or quality, nor for recruitment and retention of workers
- Incentive schemes may be individual or group based, short or long term
- Productivity or efficiency gains may be required if a scheme is to be 'self-financing'
- Organisations may use a combination of systems to meet their particular requirements

### Basic rate schemes

Basic rate schemes tend to be job-based (ie the rate for the job). A grading structure may be developed through a job evaluation scheme which is used to put jobs into an appropriate grade or band in the organisation. Pay increases may then depend on moving up a scale, skill development, promotion to another grade, or a general uprating of pay levels.

### Incentive schemes

Incentive schemes may be short- or long-term. Schemes based on individual performance, such as weekly or monthly production bonuses or commission on sales, generally offer a short-term incentive. Longer-term schemes such as profit sharing and share option schemes may not provide as much incentive to individual workers as schemes based on personal performance. They can, however, help to generate in workers a long-term interest in the success of the organisation.

Pay is not the only factor that might produce enhanced performance. As well as the job-related factors mentioned earlier, additional payments, non-contributory pension schemes, and non-cash benefits such as cars, life insurance, and assistance towards child care (eg workplace nurseries/crèches) may all play a part. Nevertheless, the prospect of higher pay for increased output/quality often provides an incentive and many schemes are introduced in the clear expectation that performance will thereby be improved.

Increases in pay are often linked to productivity or 'self-financing' pay schemes, especially where organisations have no 'new' money to put into the pay rates. In such systems the results of increases in productivity and efficiency can be shared between the employer and workers to their mutual benefit. There is an increasing trend for organisations to build a quality factor into incentive scheme calculations, offering additional payments for reductions in waste, more good quality goods or services and increased customer satisfaction. Productivity and efficiency schemes can be based on individual, group or organisation performance dependent upon the needs of the organisation and the availability of suitable performance measures.

Organisations often use a combination of systems to provide greater flexibility in the pay package to address particular needs. For instance they may have a basic rate for the job, with a top-up increase that is self-financing, and an element for individual performance.

This has been particularly common in the public sector and the privatised ex-public sector/agencies.

## Selecting and installing a pay system

Key Points: -

- Accept that there will inevitably be a cost involved
- Avoid most potential problems with a systematic, well-timed and carefully planned approach
- Involve the workforce, or its representatives, as much as possible, perhaps through a joint working party
- Re-examine the reasons for change and take advice both inside and outside the organisation. Obtain expert help if needed
- Don't just discard the existing system - take stock through discussions to enable the organisation to keep the good and change the less good
- Identify what the new system is required to do - how does it relate to the organisation's overall objectives?
- Look at the possible new systems and consider which might best suit the particular organisation, with or without alteration
- Changes to pay make people anxious, and so the new system should be kept simple and agreed with the workforce and their representatives
- Prepare the way carefully with briefings to the workforce and management. Look out for any changes to differentials and relativities. Document the system and if possible run it for a trial period
- Build in as much time as possible for proper discussion and consultation
- Make arrangements for maintenance, monitoring and evaluation. Review the system regularly to ensure it is performing as required
- Be careful the system does not directly or indirectly discriminate between men and women

### **Accept the cost**

Any consideration given to changes in the pay system mean costs will be incurred - management and staff time, expert help if necessary, as well as the actual pay costs that are likely to result.

### **Be systematic**

A systematic approach to considering and introducing a new pay system is likely to be more successful than trying to deal with problems only as they arise. Careful planning, and above all the involvement of workers, can avoid many potential difficulties.

### **Involve your workforce**

Involving the workforce is important for several reasons:

- workers and their representatives may be able to contribute valuable information, which management could be unaware of, about the operation of the existing system and the likely effect of a new one

- time, trouble and expense can be saved, especially by reducing any risk of disagreement at a later stage, particularly if existing differentials are likely to be affected
- workers will have more opportunity to understand the new system and the reasons for the change and are therefore more likely to accept it, especially if their representatives are fully involved in its design.

In organisations where an independent trade union is recognised, the employer is required to disclose to that union any information necessary for collective bargaining<sup>(1)</sup>, and this is likely to include information about pay systems.

Selecting or changing a pay system may have repercussions on pay differentials and relativities as well as on individual rewards and should be done in agreement with trade union and worker representatives.

Consultation between management and workers and their representatives should identify any potential problems in this area before the system is installed.

A recent European directive giving employees in the UK new rights to information and consultation has been agreed. The directive gives employees the right to be informed about the businesses' economic situation and to be informed and consulted about employment prospects and about decisions which may lead to substantial changes in work organisation or contractual relations, including redundancies and transfers. The UK has until 23 March 2005 to implement the directive which will be restricted initially to businesses with 150 or more employees. By 2007 the directive will be applied to businesses with 100 or more employees and by 2008 to businesses with 50 or more employees. The directive does not apply to businesses with fewer than 50 employees.

An effective way to consult is by the establishment of a working party, drawing in the experiences of representatives of management and workers. Such a group can provide feedback and evaluation right through the process of selection, tailoring for the organisation, piloting and training. The group will also be involved with the formulation of procedures and policies and through this, the workers and management are much more likely to take ownership of the scheme, promoting its success. Expert help may be necessary to assist the group.

### **Take stock of the existing system**

Re-examine the reasons for considering change and take advice both inside and outside the organisation, perhaps including expert opinion. Discussions and consultations between worker representatives and management can offer the organisation the opportunity to review the existing system. For example:

- it may be found that faults are more apparent than real and less extensive adjustments may produce a better working system for the organisation
- the current system may have merits which the parties want to incorporate into any new system - taking stock allows these to be identified and their place considered in any revised pay system.

Thus any new system builds on the strengths of the old.

## Identify the objectives

The objectives of the pay system needs to be identified and related to the organisation's overall objectives. For example are they to:

- increase productivity?
- control unit labour costs?
- recruit, retain and motivate suitably qualified workers?
- improve quality?
- move towards, or encourage, teamwork?
- change organisational culture and attitudes?
- simplify the existing system?
- reduce conflict arising from the existing system?
- comply with the law on equal pay? (see [Appendix 2: The right to Equal Pay](#))

## Select a new scheme

In selecting the most appropriate and acceptable type of system, consider whether:

- one type of system suits the work-process more than any other
- volume of output, or predictability of output, have higher priority
- the system needs to cover additional factors such as new technology, reduction of waste, staffing levels
- as changes may be made to pay rates, some jobs may require 'red-circling' of current pay levels to avoid detriment to individuals - the ideal system may be too expensive
- all staff, production and non-production, are to be covered in the new system
- the new scheme complies with the law on equal pay

## Shape to local needs

In shaping the system to meet local requirements, consider:

- what measures will be used in assessing performance - for instance individual, team, group, enterprise based
- how standards will be set - perhaps by work measurement or reference to past performance
- whether the measures and standards are free from any elements of bias or discrimination and comply with relevant legislation such as the law on equal pay, the prevention of discrimination in employment and the national minimum wage
- how the organisation will deal with relativities and differentials
- how management and worker representatives will jointly review the system and address changing standards.

These considerations hold true whatever the type of industry or service - they are as important in a 'high-technology' environment as in a service industry or a manufacturing organisation.

## Keep it simple

The overall aim must be to keep the system as simple and straightforward as possible. People need to be able to calculate their earnings, or at least understand how they have been calculated. They may otherwise become de-motivated and dissatisfied.

Any changes to pay can make people anxious. The best schemes:

- are clear and easy to understand
- take account of the needs of the organisation and the workforce
- allow for flexibility to be built in to meet changing environments
- are straightforward and cost effective to administer
- are developed with the participation of worker representatives
- have the commitment of management and the workforce.

Changes to pay systems should always be agreed with workers and their representatives. Proper consultation and thorough preparation will help to make sure that pay is fair and acceptable to workers, and complies with relevant legislation, such as the law on equal pay, discrimination and minimum wage. Changing pay systems without the agreement of workers may be in breach of contract and may result in complaints to employment tribunals or other legal action.

### **Prepare the way**

Give thought to the mechanics of the introduction of the system. Any new pay system is likely to focus attention on problems that might be outside the scope of the system. Wherever possible these should be eradicated before the new system is introduced. For instance, if internal pay relativities are an issue, it may be appropriate to apply job evaluation before commencing the new system(2).

For example, women have the right to equal pay with men if they are doing 'like' work or work that is of 'equal value'. As pay arrangements are often very complicated it is, therefore, good practice to evaluate the existing pay system in order to help avoid any sex discrimination. The Equal Opportunities Commission's Code of Practice on Equal Pay and Equal Pay Review Kit can help companies implement fair pay systems (tel 08456 015 901 or visit [www.eoc.org.uk](http://www.eoc.org.uk))

Allow as much time as possible, making changes to pay systems cannot be a 'quick fix' - time for discussion and consultation needs to be built in to achieve a successful result.

### **Install the system**

Preparations should include:

- briefing the workforce about the new system and how it is intended to work
- training supervisors, managers, and worker representatives so that they understand the nature of the system and can answer many of the potential queries - agree a communications policy with any working group/employee representatives to avoid misunderstandings
- if the new system is expected to improve productivity, making sure that all departments will be able to respond
- proper documentation of the system so that room for misunderstanding is minimised.

If possible run the new system for a trial period, with a review at the end to allow for adjustments to be made in the light of experience. In the early stages it is essential to recognise and deal with any anomalies or problems fairly and quickly.

### **Maintain, monitor and evaluate**

Maintenance, monitoring and evaluation of the system are on-going processes. While these are clearly management's responsibility, worker representatives may well have a valuable contribution to make to the evaluation process. They are likely to quickly hear of any problems,

particularly if the scheme has involved new job roles, changes in relativities, or new skills requirements. The introduction of new machinery and technology may also have an impact on the pay system by altering standards and work measures.

It is essential that any pay system should not discriminate between men and women. Both may claim equal pay where they are employed on like work, or work rated as equivalent, or work of equal value<sup>(3)</sup>. It is the employer's responsibility to demonstrate that evaluation methods do not discriminate. Monitoring of the pay scheme should be designed to identify differences related to gender, race, disability or age in the way pay is allocated.

The Equal Opportunities Commission has produced an Equal Pay Tool Kit which sets out a five-step process for undertaking an equal pay audit. The five steps are:

1. Deciding the scope of the review and identifying the data required
2. Identifying where men and women are doing equal work
3. Collecting and comparing pay data to identify any significant equal pay gaps
4. Establishing the causes of any significant pay gaps and deciding whether these are free from discrimination
5. Developing an Equal Pay Action Plan if there are gaps between men and women's pay or, if not, reviewing and monitoring

The review kit can be obtained by calling the EOC on 08456 015 901 or via their website at [www.eoc.org.uk](http://www.eoc.org.uk). Acas can also help companies undertake equal pay audits - find your nearest office in the local telephone directory or visit [www.acas.org.uk](http://www.acas.org.uk).

Action must be taken to eliminate any possible discrimination - if necessary review weightings, benchmark jobs, factors used in any job evaluation techniques. Check that all sectors of the workforce are involved in the design of the scheme. Ensure that those conducting any job analysis are properly trained, including in bias awareness techniques.

Regular reviews will keep the system on track by addressing any issues that have arisen - ensuring its continuing acceptance by the workers. A joint pay review committee can assist in this process.

## Basic rate system

Key Points: -

- Basic rate systems are straightforward but may not provide incentives to individual workers

Under basic rate systems a worker is paid in relation to a given period of time - an hourly rate, weekly wage or annual salary. Generally this rate is the established rate for all workers in one category, but there are often incremental scales which allow for progression, perhaps as additional experience and skills are obtained.

Basic rate pay systems have the advantages that:

- they are relatively simple and cheap to administer and allow labour costs to be forecast with accuracy
- they lead to stability in pay and are easily understood by the workforce, who will be able to more readily predict and check their pay
- there may be fewer disputes and individual grievances than under systems linking pay to performance or results.

However:

- basic rate systems do not by definition provide direct incentives to improve productivity or performance. Nevertheless employers may prefer to operate simple basic rate systems and improve the design of jobs, so that the job provides the necessary interest, motivation and satisfaction
- basic systems may be criticised by individual workers, who wish to see their own abilities specifically rewarded
- basic rate systems can also lead to a rigid, hierarchical system of spot-rates or pay ranges.

Basic rate pay systems are likely to be particularly appropriate in circumstances where:

- all workers do identical or similar work
- the volume or quality of work is difficult to measure, or where the workflow is uneven
- where the volume and/or pace of work is outside the workers' control
- where high output is not as important as other considerations (eg quality, stable production levels).

## Incentive schemes for individuals

Key Points: -

- Individual payment schemes include payment by results, piecework and bonuses, work measurement (including measured day work) and appraisal and performance related pay
- Other individual types of scheme include market-based pay, which links pay to what is available outside the organisation, and competency/skills based pay, which offers the opportunity for higher reward based on the acquisition and utilisation of additional skills and competencies

Many sectors of employment use pay systems that contain direct links to individual performance and results. On an individual basis this may be via:

- payment by results (PBR) eg bonus, piecework, commission
- work-measured schemes and pre-determined motion time systems
- measured day work (MDW)
- appraisal/performance related pay
- market-based pay
- competency and skills based pay.

### Individual payment by results (PBR)

The aim of any PBR scheme is to provide a direct link between pay and output: the more effectively the worker works, the higher their pay. This direct relationship means that incentives are stronger than in other schemes. However, traditional bonus, piecework and work-measured schemes have declined in recent years, as many employers have moved to all-round performance rather than simple results/output based pay. Many bonus schemes incorporate quality measurements or customer service indicators in the assessment to avoid the likelihood of workers cutting corners or compromising safe working methods in order to increase output.

Earnings may fluctuate through no fault of the individual. Supervisors and managers may fail in their responsibilities towards workers by inconsiderate allocation of work or using the incentive scheme to control output. Targets may not be accurate enough resulting in the perception of easy or difficult jobs. Material shortages or delays can affect production. Individual skills are not rewarded and indeed the most skilled may be put onto more difficult and potentially less rewarding work.

In instances where workers regulate their own output to satisfy their individual needs production can be affected and forward planning made more difficult.

### Piecework, bonus schemes and homeworkers

Piecework is the simplest method of PBR – workers are paid at a specific rate for each 'piece' of output. This means the system is straightforward to operate and understand, although open to the disadvantages that quality and safety may be compromised to achieve a higher output. Pieceworkers must be paid at least the national minimum wage and there are special rules for working this out(4).

Other individual PBR schemes include incentive bonus schemes where for instance an additional payment is paid when volume of output exceeds the established threshold, or where there is an increase in sales which exceeds given targets. Variable bonuses can also be paid in relation to performances achieved against pre-determined standards so that the higher the performance achieved, the greater the level of bonus generated.

Homeworkers must also be paid at least the national minimum wage, with employers being able to demonstrate that they have worked out rates paid to homeworkers to ensure compliance.

## **Work measured schemes**

Work measurement is often used to determine target performances and provides the basis for many PBR schemes for shop-floor workers. In these systems, a 'standard time' or 'standard output level' is set by rate-fixers, or by work study, for particular tasks. Work study calculates a basic time for a task by using laid down methods, observing workers performing the operation and taking into account their rate of working.

Incentive payments are then linked to performance or to the output achieved relative to the standard, or to the time saved in performing the task. British Standard Institution (BSI) formulas are frequently used to calculate the incentive payment and examples of these are in the [Appendix: Examples of some commonly used schemes](#).

As the setting of standard times usually includes an assessment of how the individual being studied is performing, which can have a significant impact on bonus earnings, such judgements often result in disputes. Organisations using this system often train trade union representatives in the technique to promote understanding of the way judgements are made.

An alternative is to use 'pre-determined motion time systems (PMTS)'. In these systems a synthetic time for a job is built up from a database of standard times for each basic physical movement. A common form of this system is Methods Time Measurement (MTM). Allowances for relaxation and contingencies are then added to the basic time to form the standard time for the task. Such systems are arguably less open to dispute than work-measured schemes as long as the synthetic times upon which the standards are based are acceptable to the workers and their representatives.

When the organisation is considering the relationship of performance to reward there will generally be a starting point from which additional pay is attracted - performance at or below the starting point attracts no additional payment, but performance above the starting point attracts additional payment at a proportion of the basic wage or bonus calculator. Most schemes are 'straight proportional', which allow the reward to rise in direct proportion to the rise in performance. Examples of proportional incentive schemes are in the [Appendix: Examples of some commonly used schemes](#).

Schemes should include provisions covering the effects of downtime or other non-productive time on pay. Schemes should be controlled fairly and regularly reviewed to ensure there is no degeneration of work-measured standards. The operation of the scheme should be audited regularly. Arrangements need to be in place to accommodate changes in product, material, specifications and methods - remeasurement of the job may be necessary.

Work-measured schemes may be appropriate in organisations that work on short-cycle repetitive work, where changes in methods are infrequent, where shop-floor hold ups or downtime are rare and where management should be capable of successfully managing the scheme to increase productivity. Procedures should be in place to deal with any grievances or issues that might arise. Even the simplest systems require a set of rules or guidelines to ensure fairness and equal earning opportunity for equal effort.

## **Measured day work**

Measured day work (MDW) is a hybrid between individual PBR and a basic wage rate scheme. Pay is fixed and does not fluctuate in the short term providing that the agreed level of performance is maintained. MDW systems require performance standards to be set through some form of work measurement and undergo revisions as necessary. Motivation comes from good supervision, goal setting and fair monitoring of the worker's performance.

MDW is difficult and costly to set up and maintain. It requires total commitment of management, workers and trade unions. There must be effective work measurement and efficient planning, control and inventory control systems. The pay structure is often developed by job evaluation and with full worker consultation.

A version of MDW is 'stepped' MDW. Under this scheme the worker agrees to maintain one of a series of performance levels and different levels of pay apply to each one. Movement between levels is possible, usually after a sustained change in performance.

MDW is now relatively rare. It suits organisations where a high, steady, predictable level of performance is sought, rather than highest possible individual performance. MDW may be worth considering where stability of earnings is important, or where the manufacturing cycle is lengthy.

### **Appraisal/performance related pay**

Appraisal/performance related pay is generally used to link progression through a pay band to an assessment of an individual's work performance during a particular reference period, often a year. Alternatively, the reward may be an additional sum of money paid in the form of a bonus.

Assessments usually relate to an individual's achievements against agreed objectives relating to output and quality of work but may also include an element of evaluation of personal characteristics, such as adaptability, initiative and so on(5).

Advantages of appraisal-related pay:

- it may provide a 'felt fair' system of rewarding people according to their contribution
- higher performance within the organisation may result
- it provides a tangible means of recognising achievements
- people understand the performance imperatives of the organisation
- the link between extra pay and extra performance is clear.

Disadvantages:

- appraisal-related pay can prove difficult because measurements of individual performance may be broad and lack objectivity and may be inconsistent
- as noted, such schemes also usually involve only an annual assessment and payout, which may weaken any incentive effect
- many appraisal-related or performance pay schemes pay quite small sums in terms of performance pay progression or annual 'bonus'. While any such scheme may encourage workers to focus on organisational objectives, they are unlikely to provide a great deal of individual motivation and may even demotivate.

Linking pay to appraisal can also have the disadvantage of turning the appraisal into a backward looking event where assessments are made and where workers may become defensive, as opposed to using the appraisal to look forward and agree new objectives, discuss development and any training needs. Where pay is at stake the individual may be less receptive to work counselling and may seek to negotiate softer objectives at the outset.

If a worker rated 'less than satisfactory' receives no increase at all under an appraisal pay scheme their motivation and morale may be adversely affected. It is important therefore to focus appraisals on the assessment of performance, the identification of training needs and the setting of objectives, not on any dependent pay.

Any organisation that chooses appraisal related pay should have good industrial relations and good communications systems in place. It is also important that the finance necessary to operate the scheme is available. Appraisal related pay is most successfully introduced when it is linked to an existing appraisal scheme that is working well, rather than a simultaneous introduction of appraisal and appraisal-related pay.

It is important to monitor the appraisals, to pick up any drift from the overall distribution of ratings and to check the fairness, equity and consistency of the ratings.

Recent surveys have shown that individual performance related pay schemes maintain popularity, particularly for senior managers in the private sector. They have also been introduced in the public sector, and lower level jobs in both sectors.

Managers need to be trained to operate individual performance related pay schemes and should be aware that team-working may be adversely affected - such schemes may prove divisive as workers seek their own performance improvements without consideration of any effect on the work-team and perhaps withhold help and information from co-workers.

Individual performance related pay needs to be carefully considered in the light of any organisational move towards teamwork and worker involvement. Such schemes also tend to lack the transparency sought by workers to properly understand how their pay is decided.

### **Market-based pay**

Market-based pay links salary levels, and progression through the scales, to those available in the market. It is often used in conjunction with a performance pay matrix, which allows faster progression from the bottom of the scale to the market rate, which will be the mid-point. Progression then slows, regardless of the performance of the worker, as they are deemed to be earning above the market rate for their job. It is rarely used as a scheme in isolation, but may be part of a reward strategy incorporating several performance elements.

### **Competency and skills-based pay**

Competency and skills-based pay schemes have increased in popularity in recent years. A direct link is created between the acquisition, improvement and effective use of skills and competencies and the individual's pay.

Competency and skills-based schemes measure inputs, ie what the individual is bringing to the job, unlike traditional performance based schemes which measure outputs.

Competency may be generally defined as the ability of an individual to apply knowledge and skills and the behaviours necessary to perform the job well.

Competency based systems have become more wide-spread because many organisations already use competencies in recruitment and in performance appraisal for non-pay purposes, such as development and training. It goes along with the increasing tendency for pay to be linked to the abilities of the individual rather than a single set rate for the job.

Competency based pay is often used in conjunction with an existing individual performance related pay scheme and will reward on the basis of not only what the individual has done, but how they have achieved their targets. Examples of competencies may include leadership skill, or team-working ability. Competency-related pay fits well with an overall organisational philosophy of continuous improvement.

Difficulties may arise in defining the competencies valued by the organisation. There are differences between behaviours that are in-built and those that can be developed. Problems may also arise because of the complex nature of what is being measured and the relevance of the results to the organisation. Judgements about people's behaviour may be less than objective.

Competency assessment rests on several factors - identifying the correct competencies, choosing the right form of assessment and crucially, training the assessors to make accurate, objective judgements.

Skills-based pay also rests on workers gaining new and improved skills - often in a manufacturing environment. Reward is given for skills that can be used in other jobs in the same job band, encouraging multi-skilling and increased flexibility. Workers may also be allowed to develop the skills of a higher job band. Skills may be based on National Vocational Qualifications or internal evaluation and accreditation.

Both competency-based and skills-based pay have similar advantages and disadvantages:

Advantages:

- increased skill and flexibility in the workforce
- reduction in traditional demarcations
- increased efficiency
- tangible benefits for workers in return for changes in working practice.

Disadvantages:

- payroll costs will increase as workers gain higher rewards for increased skills
- increased training costs (time and expenses)
- employers may be paying for skills/competencies rarely used
- queuing for training - if people cannot be released, then there might be resentment and questions of fairness
- can de-motivate once workers reach a ceiling of their training opportunities or there are no higher grade positions available when they have completed their training
- highly trained workers will be more marketable and may be 'poached' or tempted to leave.

## Incentive schemes for groups

Key Points: -

- Group pay schemes include those based on the performance of the team, plant or company. They also include 'gainsharing', which is a form of added-value scheme which links pay to the achievement of organisational goals. Share incentive plans involve the provision of shares to employees - either by giving them direct or allowing them to be bought - and can be related to performance.

Some organisations utilise pay systems based on the performance of the team, or group. Sometimes it may be the performance of the whole plant or enterprise that is the trigger for the performance elements of pay.

### Team-based pay

While team-based pay has been around for some time - in the shape of departmental or group bonus systems - it has taken on more importance with the increased interest in teamworking.

In team-based pay systems the payments reflect the measurable goals of the team. Teamworking may be most effective in situations involving high task interdependence and creativity, although it can be difficult to define the team, the goals, and the appropriate reward. Schemes can be divisive if they are not open and transparent. Goals should not be shifted once agreed - they need to be achievable.

The aim of team-based pay is to strengthen the team through incentives - building a coherent, mutually supportive group of people with a high level of involvement. The team achievements are recognised and rewarded. Peer group pressure can also be helpful in raising the performance of the whole team.

As with any other pay system, involvement of the workers who will be affected is crucial in the design of the scheme. They must be involved particularly in the way objectives are set, how performance is measured, and the basis on which team rewards are distributed.

Team-based pay has both advantages and disadvantages:

Advantages:

- it can encourage teamworking and co-operation between workers
- team goals can clearly be integrated with organisational objectives
- it encourages less effective performers and acts as an incentive for the whole team to improve
- it may help in developing self-management within the team
- it enhances flexibility of working and encourages multi-skilling.

Disadvantages:

- difficulty in defining the team
- it can take time for teams to become well-defined and work together effectively
- individuals may feel their personal self-worth is diminished
- peer pressure could be oppressive and lead to conformity rather than creativity. Pressure on individuals perceived to be under-contributing or not 'fitting in' can degenerate into bullying and/or harassment
- inter-team competition may become dysfunctional for the organisation as a whole

- once effective the team could prove difficult to change or break-up in response to changing processes, markets or competitive pressures
- each team should have equality of earnings opportunity or inter-team movement will be restricted
- introducing a new member to a team may be problematic, if the team perceive that their earnings could be affected by a less skilled operator
- reduced flexibility because individuals in high performing teams are often reluctant to move to other teams

### **Plant or company based pay**

Plant or company based performance pay schemes are based on larger groups than teams, for instance, divisional, plant or the whole organisation. They may well use the same factors as team-based or individual performance schemes, or perhaps total sales within a set period, or comparative reductions in labour costs.

The most common forms of plant or company based payment systems tend to be based on overall profits (profit sharing), or alternatively on schemes that owe more to the improvements within the direct control of the workforce, such as added value or similar types of gainsharing systems. Overall profitability in an organisation is subject to factors outside the workforce's control, such as depreciation, economic changes, taxation, as well as the productivity improvements of individuals and therefore may not reflect real efficiency gains by the workforce.

Plant/company based pay schemes are generally most effective in organisations where the workforce can clearly see the results of their efforts. They are successful where communications and employment relations are good and where the performance measurement is not subject to major changes arising from external causes.

There are advantages and disadvantages to plant and company based pay schemes:

Advantages:

- they can encourage wider co-operation within the plant, with workers being more aware of their contribution to the total effort of the organisation
- they provide a more obvious and direct link with the organisation and its ability to pay
- they may encourage greater flexibility in ways of working to increase efficiency and productivity.

Disadvantages:

- the direct incentive value of such schemes tends to be relatively weak, as the link between daily work and bonus may seem quite remote, especially if the payments are quarterly or annually
- bonus payments may come to be seen as part of normal pay
- added-value schemes may involve complex financial information and may be difficult to understand.

## Gainsharing

Gainsharing is a form of added-value pay scheme linking workers' pay to the achievement of organisational goals by rewarding performance above a pre-determined target. This may be in the form of a share in the profits generated by sales, or on measures of customer satisfaction, but is almost always led by measures of productivity, performance and quality.

Gainsharing schemes have to be based on factors that are in the workers' control.

Gainsharing should be part of a long-term strategy to improve communications, staff involvement and teamwork. The goal is not to work harder, but more effectively. It may be used as a replacement for bonus/piecework schemes, where quality is sometimes lost to quantity.

All workers and management who have any involvement in the product of the organisation should be included in any gainshare plan. In this way their support is encouraged so that they can feel a direct responsibility for the plan's success. Performance measures and results should be made available and everyone encouraged to offer suggestions for improvements. Open communications and exchange of information are crucial.

Common types of gainsharing schemes include:

### Scanlon plan

- this formula measures labour costs as a proportion of total sales and sets a standard ratio which will trigger some distribution of savings to a pre-established formula.

### Rucker plan

- this is a refinement of the Scanlon plan which measures labour costs against sales less the cost of materials and supplies and provides a simple added-value calculation.

### Other gainsharing / value-added schemes

- there are several forms which further refine the calculations and link bonus payments to the increase in added value, above a given norm. Value-added deducts wages and salaries, administration expenses, services and materials from income derived, and thus represents the value added by the production or other process within the organisation. The level of added value of an enterprise is an indicator of its efficiency.

Some examples of the above gainsharing schemes are included in the [Appendix: Examples of some commonly used schemes](#).

## Share incentive schemes

Share incentive schemes involve the provision of shares to employees - either by giving them direct or allowing them to be bought. The aim is to encourage staff involvement in the company's performance and therefore improve motivation and commitment.

The Share Incentive Plan (previously the All-employee share ownership plan (AESOP)).

The share incentive plan ("SIP") was introduced by the government as part of the 2000 Finance Act. SIPs can include four types of shares:

- Free shares - companies can give up to £3,000 worth of shares a year to each employee
- Partnership shares - employees can buy up to £1,500 worth of shares a year
- Matching shares - companies can reward this commitment by giving up to 2 matching shares for each partnership share an employee buys

- Dividend shares - companies can provide for dividends paid on free shares, partnership shares and matching shares to be reinvested in further shares

Companies can award some or all of their free shares on the basis of performance - so long as they satisfy certain criteria laid down by HM Revenue & Customs (for more information visit [www.hmrc.gov.uk/shareschemes](http://www.hmrc.gov.uk/shareschemes) or telephone 020 7147 2843/53).

### **Other schemes**

Examples of other share incentive schemes include:

- Savings Related Share Option Schemes (SAYE) - tax advantaged share option scheme for all employees and directors. Participants save up to £250 per month and use the savings and tax-free bonus to exercise their options and acquire shares at the end of a 3, 5 or 7 year period.
- Enterprise Management Incentives (EMI) - companies with gross assets not exceeding £30 million can grant tax and NIC advantaged share options worth up to £100,000 each to any number of employees, subject to total share value of £3 million under EMI.
- Company Share Option Plans (CSOP) - up to £30,000 worth of share options each can be granted to any number of employees with tax and NIC advantages provided the options are not exercised within three years of grant.

Although share-owning schemes can appear attractive to employers it is not always helpful to a company's finances to have a constant turnover of shareholders. Companies therefore need to be clear about how much of the equity can be held in this way and how to create ways to get workers to keep their shares long-term.

## Trends in pay structures

- Pay structures are often used to develop flexibility and an increased knowledge in the workforce of the organisation's business needs
- Newer pay structures are moving towards a flatter, less hierarchical shape, where pay rates may be incorporated in fewer, broader bands
- Many organisations are moving away from traditional management/worker demarcations and are 'harmonising' their pay systems
- Total rewards statements can help employees identify every aspect of their reward package
- A cafeteria style of benefits allows employees to exchange different parts of their reward package - such as holidays or company cars

Organisations are increasingly looking at ways to improve business performance. They are developing pay structures and systems which promote:

- the acquisition of skills
- increased flexibility
- greater awareness of business requirements
- a strong link between individual/team pay and the overall well-being of the organisation.

There has been a shift in emphasis from valuing the job towards valuing the individual. Pay structures tend to be less hierarchical, with pay systems which reward individuals according to their contribution towards individual or corporate goals.

### **Broad-banding**

Broad-banding is the reduction of many narrow pay bands down to fewer but wider bands - typically four or five - each encompassing a number of grades. Similarly, much wider role definitions are developed which cover several of the former jobs they replace. This flattens the structure of the pay and grade hierarchy and may increase flexibility, dispensing with the need for constant regrading and promotion exercises. Job evaluation and market relativities are normally used to determine base rates for jobs and may continue to be used for monitoring and dealing with any equal pay issues that might arise(7).

The adoption of a broad banded structure shifts the emphasis to evaluating the individual, focusing on lateral career development and on competency growth rather than upward progression through a hierarchy(8).

When broad-banding is introduced, organisations often increase the use of some kind of performance related pay to allow for individual movement within the bands. Care needs to be taken in determining the widths of the bands. Too broad a band runs the risk of giving unrealistic expectations to those near the bottom, so some organisations have introduced bands within bands - 'zoning' - to contain expectations and make the structure more easily understood.

Broad-banding is most likely to be appropriate where an organisation is seeking to integrate reward systems with other human resource processes and where the organisation is developing new, often devolved, pay strategies.

Broad-banding can support team-working (and thus possibly team-based pay) and allow the introduction of skill or competence based pay systems to encourage workers to move upwards within the band.

## **Harmonisation/single status agreements**

Harmonisation/single-status agreements offer opportunities to organisations to evaluate and harmonise their pay systems. Harmonisation/single-status agreements are those that give the same terms and conditions to all workers in the organisation. They often include integrated job evaluation schemes and may have elements of competency/skill-based incentives. They can help to break down barriers, increase flexibility, and help the organisation realise equality in pay issues.

## **Total Reward**

Pay has traditionally been seen as the main financial incentive for employees. However, pay is only one way of rewarding employees, and does not include employee benefits such as pensions as well as less obvious things like the working environment and career development. Some employers are issuing total reward statements so that employees can identify all the elements of their reward package in a single document.

Wherever possible, each element is costed. This might help employees weigh up the overall value of their reward when considering a career move.

Typical elements in a total reward statement include:

- pension benefits and employer contributions
- holidays with pay
- maternity/paternity leave
- sick pay
- childcare vouchers
- salary advances and loans
- financial assistance in connection with staff moves
- staff discount schemes
- company and lease cars
- medical insurance
- paid membership of societies
- share ownership

Other less obvious benefits might include:

- flexible working
- employee counselling
- training, learning and development
- facilities (such as car parking, good working environment etc)

## **Flexible or 'cafeteria' benefits**

Once employees can identify all the benefits they get at work they may have the opportunity to exchange different parts of their reward. For example, childcare vouchers can be issued as an alternative to an element of pay.

The success of a particular element is often influenced by how the benefit will be treated for tax purposes. If the benefit is more tax efficient than the equivalent salary there is an incentive to opt for the benefit rather than the salary. Company cars have proved to be less popular since the taxation rules have become more stringent.

The domestic circumstances of the employee are also important. For instance, someone with young children may be interested in purchasing additional holidays or exchanging pay for childcare vouchers. Someone who is simply interested in earning as much money as possible may prefer to trade in some holidays in exchange for pay.

Common flexible benefits are:

- buying and selling holidays
- childcare vouchers
- advances and loans
- company cars
- company shares
- private health schemes
- medical insurance

The adoption of a 'cafeteria' approach still tends to be confined to executive levels where they are more likely to be in a position to negotiate their own contracts. At lower levels, employees take advantage of various elements on an ad-hoc basis. For example, they might take advantage of staff discount schemes or receive a salary advance to purchase season tickets etc.

The development of a flexible benefits package can be time consuming and require detailed financial knowledge. Employee benefits consultants are often used to gauge the likely take up and assist in the implementation.

## Conclusion

The area of pay systems is one of the most vital in the whole field of employment relations - it is naturally of major interest to workers what they are to be paid and how they may increase their earnings. An acceptable and effective pay system, which maximises levels of service, productivity and quality, while providing fair and reliable pay, is essential to harmony and efficiency in the workplace. Goodwill and motivation will be undermined if pay systems are not 'felt fair' by the workforce.

All pay systems should comply with the law on equal pay. Women have the right to equal pay with men if they are doing 'like' work or work that is of 'equal value'. As pay arrangements are often very complicated it is, therefore, good practice to evaluate the existing pay system in order to help avoid any sex discrimination. The Equal Opportunities Commission's Code of Practice on Equal Pay and Equal Pay Review Kit can help companies implement fair pay systems (tel 08456 015 901 or visit [www.eoc.org.uk](http://www.eoc.org.uk))

Clearly, for any system to be successful, it must be designed to suit the particular needs and circumstances of the organisation. It must be carefully monitored and evaluated, with reassessments and revisions if necessary. The detail of the system should be communicated both individually and collectively - perhaps through an organisational handbook, or by company internal computer systems (email/intranet). Face-to-face meetings by line management are also valuable in briefing on pay developments.

One of the key elements in a successful pay system is the involvement and agreement of the workers and their representatives in its design and implementation. Every opportunity should be made for participation and contribution. This is often through joint working parties, steering groups, or an already existing joint consultative committee/works council. A good system is the joint responsibility of management, workers and trade unions/representatives.

## Appendix: Examples of some commonly used schemes

### Individual payment by results schemes

Most individual payment by results schemes are based on performance ratings, generally using the British Standard Institution formulae(9) on which:

- 75 performance equates with a normal (ie: non-incentive) level, such as a worker receiving time rates could expect to achieve
- 100 performance equates with a standard level such as a qualified worker receiving payment by results could expect to achieve.

Where the basis of the scheme is to pay for increased productivity (the ratio of output to input), the following calculation is used to express the percentage performance achieved:

$(\text{standard minutes produced (output)} \times 100) / \text{actual time taken (input)}$

For example, where the standard time to produce an item is 5 minutes and the working day is 8 hours (480 minutes) and the worker produces 80 units, the rating would be calculated as:

$(\text{output (80 units} \times 5 \text{ minutes per unit)} \times 100) / \text{input (8 hours} \times 60 \text{ minutes)} = 400 / 480 = 83.3$

If the worker produced 120 units the performance rating would be:

$600 / 480 \times 100 = 125$

### Straight proportional PBR schemes

In proportional schemes the incentive payment is in direct proportion to performance. On the BSI 75/100 scale for example, basic rate is paid at 75 performance, a 100 performance increases earnings by a third, and earnings are pro rata for other levels of performance. A minimum level of earnings is often guaranteed as a fall-back and this would normally be at the basic, or 75 performance, level in this illustration. The following graph shows the relationship between earnings and performance in a straight proportional scheme.

A standard time for the job is determined using work measurement techniques. The work value of 100 completed jobs with a value of two standard minutes, for example, would be 200 standard minutes - regardless of the time actually taken to complete the jobs. An operator on PBR working at standard performance for a full day of, say, 8 hours (480 minutes) would complete 240 jobs - a total work value of 480 standard minutes. If only 200 jobs were completed in an uninterrupted day, the employee's performance would be:  $\text{standard minutes produced} \times 100 = 400 \times 100 = 83.3$

actual time spent on PBR work

$(\text{standard minutes produced} \times 100) / \text{actual time spent on PBR work} = (400 / 480) \times 100 = 83.3$

In practice, a worker is likely to spend time waiting for material or for a machine to be repaired, doing authorised work outside the scope of the PBR scheme, or on authorised activities away from the workplace such as attending a training course. In calculating performance and earnings, these periods are treated separately from time spent on work within the scope of the scheme and the basis of payment for such periods (basic rates, some intermediate rate or perhaps average earnings) should be specified. Generally, workers are not penalised for matters outside their control. A typical earnings calculation might be as follows(10):

**Data**

Actual time spent on PBR work = 6 hours 40 minutes (400 minutes)

Completed PR work

= 180 items at 2 standard minutes each

= 360 standard minutes (6 standard hours)

Actual time on non-PBR work = 1 hour 20 minutes (80 minutes)

Basic rate (for 75 performance) = £3.00 per hour

**Calculation**

Standard minutes produced:  $360 \times 100 / \text{Actual time spent on PR work: } 400 = 90$  performance

Using a straight proportional payment scale where 75 performance pays basic rate and standard (100) performance pays one-third of basic pay extra:

90 performance would earn 20 per cent bonus

Therefore earnings on PBR

=  $6 \frac{2}{3}$  hrs x (£3 + 20%)

=  $6 \frac{2}{3}$  hrs x £3.60

= £24

Total earnings = £24 + 80 minutes at the appropriate agreed rate

or

Earnings per hour

=  $100 \times £3.00$

= 75

for 100 (ie: standard) performance

= £4 per hour (ie: 33% more than basic rate)

Therefore earnings for the 6 standard hours completed on PBR work

=  $6 \times £4$

= £24

Total earnings = Earnings on PBR work + earnings on non-PBR work

= £24 plus 80 minutes at the appropriate agreed rate.

**Non-straight proportional schemes**

In schemes other than straight proportional the relationship between earnings and performance varies. The main types of schemes are as follows:

- Geared schemes in which the bonus follows a straight line which, if extended below the guaranteed minimum, would not (unlike a straight proportional scheme) give precisely zero earnings at zero performance
- Stabilised schemes which are a particular type of geared scheme, in which the bonus follows a straight line which, if extended below the guaranteed minimum, would give some earnings at zero performance
- Progressive schemes in which the rate of change in earnings rises as performance rises
- Regressive schemes in which the rate of change in earnings falls as performance rise
- Differential schemes which are a combination of two or more schemes - straight proportional, geared, progressive and/or regressive - changing from one to another at specified levels of performance.

Examples of geared, stabilised, progressive and regressive schemes, indicating how they compare with a straight proportional scheme are illustrated in the diagram overleaf.

### **Plant wide payment by results scheme**

The standards used in payment by results schemes based on the volume of production of whole plants (or other groups of employees) may be determined by work measurement, but may also be derived from records of production during a reference period. When past production records are used due allowance should be made for any unusual features in the reference period and the performance of people during the period.

An example of a simple plant-wide volume based scheme follows.

#### **Data**

Examination of production records in a chemical processing plant show that over a one year period each ton of material processed required a total of ten hours of production operative's time; this productivity ratio is regarded as the standard for the basis of the scheme.

Standard productivity ratio = 10 employee hours per ton

In the current period (ie the period of, say, a week, for which earnings are being calculated in this example) the total time worked by production operatives = 24,000 employee hours

Total volume of material processed in current period = 3,000 tons

Total production labour costs in current period = £96,000

#### **Calculation**

Current period productivity ratio =  $24,000 / 3,000 = 8$  person hours per ton

Savings in employee hours = standard productivity ratio minus current period productivity ratio  
=  $10 - 8 = 2$  employee hours per ton

Therefore total savings in employee hours:  
 $3,000 \times 2 = 6,000$  employee hours

Current period labour costs =  $96,000 / 24,000 = £4$  per production employee hour

Therefore total savings =  $6,000 \times £4 = £24,000$

Under the terms of the scheme, total savings are divided, say 60:40, between workers and company. Consequently, £14,400 (60 per cent of £24,000) is available as the bonus pool for the week.

Since the total employee hours worked in the week are 24,000, the bonus payment is equivalent to  $£14,400 / 24,000 = 60$  pence per hour

Each individual production operative's bonus is paid pro rata to the number of hours he or she worked in the week.

#### **Added value**

The formula for added value is most commonly expressed as:

Sales revenue less cost of raw materials and services purchased outside the enterprise (electricity, consumable stores, transport etc) = Added value

Here is an example of how to calculate added value:

## Data

Sales

Sales revenue = £4,000

Costs

Purchased materials = £1,800

Bought-in services, heat, light etc = £200

Wages = £1,000

Salaries = £400

Total = £3,400

Profit

Profit before tax = £4,000 - £3,400 = £600

## Calculation

Added value = Sales minus (materials + bought-in services)  
= £4,000 - (£1,800 + £200)  
= £2,000

In practice, such factors as depreciation and capital investment can present difficulties when calculating added value and schemes can vary in the way they treat these items.

An example of an added value scheme of the Rucker type is given on the next page.

Added value bonus

Here is an example of how to calculate added value bonus:

Base period calculation

Net sales over three years reference period = £2,000,000

Less bought-in materials, supplies and services = £800,000

Added value over three years = £1,200,000

Employee costs over three years = £400,000

Percentage ratio of employee costs to added value / £1,200,000 = £400,000 x 100

33 1/3 per cent

Bonus calculation

Net sales over one month = £100,000

Less bought-in materials etc = £30,000

Added value = £70,000

33 1/3 per cent of added value = £23,334

Less actual wage bill = £20,000

Saving available for distribution = £3,334

Under the terms of the scheme 25 per cent of the savings (£834) goes into a reserve fund to provide a bonus for those months when no bonus would otherwise be payable; the remainder (£2,500) is divided equally between company and workers.

Thus the employees' share is equal to a bonus of:

(£1,250 / £20,000) x 100 = 6.25 per cent of the wage bill

## Appendix 2: The right to Equal Pay

The Equal Pay Act 1970, as amended by the Sex Discrimination Acts 1975 and 1986, provides that a woman has the right to treatment equal to that given to a man where the woman is employed:


- on work of the same or broadly similar nature to that of a man
- in a job which, although different from that of a man, has been given an equal value to the man's job under a job evaluation scheme.

The Act also gives a man the same rights to equal treatment with a woman.

The Equal Pay (Amendment) Regulations 1983 provide for a woman (or a man) to seek equal pay with a named comparator of the opposite sex in the same employment engaged in dissimilar work on the grounds that the work done, although different, is of equal value in terms of the demands that it makes. An employer can justify differences in pay only where the variation between the woman's contract and the man's contract is genuinely due to a material factor which is not the difference of sex. Further advice on equal pay is contained in the booklet: Equal Pay - A Guide to the Equal Pay Act, prepared by the Department Education and Skills and available from JobCentres.

The Equal Opportunities Commission has produced a Code of Practice on Equal Pay and an Equal Pay Tool Kit to help employers implement fair pay systems. These are available by calling the EOC on 08456 015 901 or via their website at [www.eoc.org.uk](http://www.eoc.org.uk).

## Notes

1. See  [Code of Practice - Disclosure of information to trade unions \[475kb\]](#).
2. Acas [Advisory booklet - Job evaluation: an introduction](#) provides a brief introduction and describes some different methods.
3. See Department for Education and Employment leaflet: A Guide to the Equal Pay Act.
4. See 'A detailed guide to the national minimum wage', or telephone 0845 6000 678.
5. See also Acas [Advisory booklet - Appraisal related pay](#) for more detail on these schemes.
6. See Acas [Advisory booklet - Teamwork: success through people](#) for more information on teamworking.
7. See Reward Management: A handbook of remuneration strategy and practice by M Armstrong and H Murlis for a detailed description of broad-banding.
8. The Institute of Personnel and Development have produced The IPD Guide to broad-banding, available from IPD, IPD House, Camp Road, London SW19 4UX.
9. British Standard Institution: BS 3138: Glossary of terms used in Management Services BSI 1992.
10. This is for illustrative purposes only and does not show the national minimum wage levels.

## Suggested further reading

**Armstrong, Michael**

Employee reward (3rd ed)  
London, CIPD, 2002

**Armstrong, Michael and Brown, Duncan**

New dimensions in pay management  
London, CIPD, 2001

**Armstrong, Michael and Murlis, Helen**

Reward management: a handbook of remuneration strategy and practice (4th ed)  
London, Kogan Page, 1998

**Armstrong, Michael**

Rewarding teams  
London, CIPD, 2000

**Brown, Duncan**

Reward strategies: from intent to impact  
London, CIPD, 2001

**Chartered Institute of Personnel and Development**

Guide to bonus and incentive plans  
London, CIPD, 2002  
(Executive briefing)

**Equal Opportunities Commission**

Code of Practice on Equal Pay and  
Equal Pay Tool Kit  
Tel: 08456 015 901  
[www.eoc.org.uk](http://www.eoc.org.uk)

**Incomes Data Services**

Bonus schemes  
London, IDS, 2003  
(IDS Study no 742)

**Work Foundation**

Bonus payments  
London, Work Foundation, 2001  
(Managing Best Practice no 82)

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