**Group Incentive Bonus Calculation Exercise**

**Overview**

Group incentive bonus plans are often organized and administered differently from individual incentive plans. In many cases, the size of the bonus pool is influenced by organizational financial performance. A threshold (minimum) level of attained sales or revenues is usually required for payments to occur such as 80% or more. A target payment may be set in relation to 100% achievement of business and operational goals. A maximum level of bonus payment may be set as well such as 120%. Bonus payments may still be apportioned separately for each employee when considering job levels, pay rates, seniority, and performance ratings.

**Establishing The Gross Monthly Bonus Pool**

The first calculation is typically one in which actual revenues are divided by planned revenues to determine the amount of funds that will be in the bonus pool. For example, if the target monthly revenues equal $5,000,000 and the actual revenues are $4,000,000, the level of attainment is 80% ($4,000,000/$5,000,000). If the gross bonus pool amount is set at 10% of actual revenues of at least 80% or more the bonus pool would be $400,000 ($4,000,000 x 10% (.10) = $400,000.

**Adjusting The Bonus Pool For Employer Reserve**

The bonus pool may be reduced in size so that the organization will have sufficient monies on hand to make incentive payments to employees, even when cash flow is disrupted. This step may be taken if company revenues are not received evenly throughout the year or there is a longer accounts receivable cycle for booked or received revenues. As your textbook readings show, this reserve is often a significant value, such as 25% of the gross bonus pool amount. So if the gross bonus pool is $400,000, the net pool would be $300,000 ($400,000 x 25% = $100,000; $400,000 - $100,000 = $300,000 = net bonus pool.

**Adjusting For Active or Ineligible Employees**

Eligibility for participation in the bonus pool may be influenced by the employee’s date of employment, employment status, and performance ratings. For example, an employee who has worked for the company for less than 90 days, or working part-time, or on a leave of absence, or rated as less than satisfactory, may not be eligible to participate in the bonus pool for that period. The organization will need to determine whether the funds will be distributed among the remaining eligible employees or whether the organization will retain a larger share of the funds in the pool to account for ineligible employees.

**Employee’s Share of The Pool- Equal Distribution**

In the most basic plans, the employees may all receive the same dollar share of the net bonus pool. For example, if the bonus pool was $100,000 and there were 20 eligible employees, each employee would receive $5,000 ($100,000/20 = $5,000). This is known as receiving a straight or equal share of the pool.

**Employee’s Share of The Pool- Adjusted For Employee Earnings**

Most employees and employers believe that equal distributions are not necessarily equitable, particularly when differences in the level of responsibility, time worked, and performance ratings are considered. So employers may adjust the bonus pool distributions by dividing employee pay by total employee payroll for eligible employees to determine the percentage of pool that each employee should earn. For example, if Employee A’s earnings are $50,000 of $1,000,000 in the net bonus pool and Employee B’s earnings are $1,000,000 in the net bonus pool (Employee A: $50,000/$1,000,000 = 5% of the total employee payroll earnings. Employee B: $100,0000/$1,000,000 = 10% of the total employee payroll earnings). So if there are $100,000 in the net monthly bonus pool, Employee A should receive $5,000 ($100,000 x 5%) and Employee B should receive $10,000 ($100,000 x 10%)

**Employee’s Share of The Pool- Adjusted For Employee Points**

There are many different ways in which to apportion the bonus pool payments by earned employee points. For example, the employee may earn 1 point for each year of service, 3 points for satisfactory performance, and 1 point for each $1,000 of annual earnings. The employee’s points would be the product of service x performance x earnings. If the employee had five years of service, a satisfactory performance rating (3) and earned $3,000 per month, their total earned points would be 45 (5 x 1) x (3) x ($3,000/$1,000) = 5 x 3 x 3 = 45. If the total points in the pool is 1,000, then the employee’s share of the pool would be 4.5% (45/1,000). If the net bonus pool is $100,000, the employee would receive 4.5% of the bonus pool or $450 ($100,000 x 4.5% = $4,500).

**COMPLETE THE FOLLOWING CALCULATIONS AND RECORD YOUR**

**ANSWERS**

**Quiz Calculation 1- Establishing The Gross Bonus Pool**

The gross bonus pool is based on 10% of gross sales between a threshold of 80% and a maximum of 120% of target gross sales. Target gross sales have been established for $7,500,000 for the month. The actual gross sales were $6,000,000. What is the dollar amount of the gross bonus pool?

**Quiz Calculation 2- Adjusting The Gross Bonus Pool For Employer Reserve**

The employer will reduce the amount of the gross bonus pool in Calculation 1 by 25% to determine the net bonus pool amount. What are the total dollars remaining in the net incentive pool that could be paid to employees?

For Quiz Calculations 3, 4, and 5 that follow on the next page, you will work from the information provided in the instructions and adjoining tables.

**Quiz Calculation 3- Adjusting For Eligible Employees**

In order to participate in the plan, you must have worked for the company for at least one year, been actively employed during the year for at least six months, and have a rating of meets performance or higher (‘3’ or above). What is the total number of employees who are eligible to participate in the plan given the list below? Do not determine eligibility based on the name of the employee!

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Name of Employee** | **Employment Date** | **Active Months Worked During Year** | **Performance Rating** | **Employee’s Earnings** |
|  |  |  |  |  |
| Paris Hilton | 08/10/09 | 1 | 2 | $10,000 |
| Brad Pitt | 06/14/94 | 8 | 3 | $50,000 |
| Tina Fey | 03/26/03 | 9 | 5 | $70,000 |
| Guy Fieri | 01/15/92 | 10 | 4 | $35,000 |
| Steven King | 11/23/95 | 7 | 3 | $120,000 |
| Meryl Streep | 04/14/79 | 8 | 5 | $80,000 |
| Lindsay Lohan | 12/22/96 | 5 | 2 | $20,000 |
| Mel Gibson | 07/15/85 | 6 | 2 | $50,000 |
| Dianne Feinstein | 09/30/80 | 10 | 4 | $80,000 |
| Robert Rizzo | 05/03/82 | 6 | 4 | $500,000 |
|  |  |  |  |  |

**Quiz Calculation 4- Employee’s Share of The Pool Based On Eligible Employee Earnings**

Based on the exercise, what should be Robert Rizzo’s percentage of employee total earnings, **ONCE YOU ELIMINATE THE INELIGIBLE EMPLOYEES** based on the conditions cited for Calculation 3?

**Quiz Calculation 5- Employee Bonus Based On Their Share of Pool Points**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Name of Employee** | **Length of Employment In Years** | **Active Months Worked During Year** | **Performance Rating** | **Eligible Employee Points For Share of Pool (use multiplication)** |
| Brad Pitt | 16 | 8 | 3 |  |
| Tina Fey | 7 | 9 | 5 |  |
| Guy Fieri | 18 | 10 | 4 |  |
| Steven King | 14 | 7 | 3 |  |
| Meryl Streep | 31 | 8 | 5 |  |
| Dianne Feinstein | 29 | 10 | 4 |  |
| Robert Rizzo | 28 | 6 | 4 |  |
|  |  |  |  |  |

If the bonus pool is $100,000, what should the dollar amount of Robert Rizzo’s bonus (be sure to only use the data displayed for the table for Calculation 5)?