Study of Separation Incentives Provided to Public Employees Under Act 253 of the 2000 Legislature

A Report to the Governor and the Legislature of the State of Hawaii

Report No. 04-04
March 2004

THE AUDITOR
STATE OF HAWAII

Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawaii State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.

2. *Management audits*, which are also referred to as *performance audits*, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits*, when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits*, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.

3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.

4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.

5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.

6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds are existing funds meet legislative criteria.

7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.

8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.

9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawaii's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.

THE AUDITOR
STATE OF HAWAII
Kekuanaoʻa Building
465 S. King Street, Room 500
Honolulu, Hawaii 96813

OVERVIEW

Study of Separation Incentives Provided to Public Employees Under Act 253 of the 2000 Legislature

Report No. 04-04, March 2004

Summary

Act 253 of the 2000 Legislature was intended to tame an unduly cumbersome civil service system. Existing civil service workforce reduction laws were unwieldy and burdensome to administer. Act 253, Part V, the separation incentives law, was created to provide the state with the necessary tools to restructure government. The law authorizes the state executive branch to offer voluntary severance or special retirement incentive benefits to state employees who voluntarily separate from service when their positions are identified for abolishment or when they are directly affected by a reduction-in-force (RIF) or workforce restructuring plan. The law also extends to other jurisdictions (the counties, the Judiciary, Hawaii Health Systems Corporation, Office of Hawaiian Affairs, and the Legislature) the option of providing special retirement incentive benefits to their respective employees under a RIF or workforce restructuring plan.

Voluntary severance is a one-time lump sum cash bonus calculated at 5 percent of the employee’s base salary for every year of service worked, up to ten years, and should not exceed 50 percent of the employee’s annual base salary. Special retirement incentive is a benefit offered to employees who meet certain age and years of service requirements.

We found that the Departments of Human Resources Development and Budget and Finance failed to properly implement and administer the separation incentives law, resulting in the inconsistent implementation of separation incentives programs in state government. We also found that the Department of Human Resources Development is not monitoring the “no reemployment” provision of Act 253, which allows reemployment breaches to occur. In one example, an employee was overpaid $7,000 in special incentive retirement benefits.

We found that the Hawaii Health Systems Corporation has implemented a separation incentives program that violates the separation incentives law. The corporation allows employees to decide if they want to participate in the separation incentives program and then abolishes their position. This voluntary, employee-driven program contradicts the intent of the separation incentives law and does not comply with its requirements.

The corporation also offers its employees an unauthorized cash buyout that has cost the State approximately $275,000.

We found that the separation incentives law has done little to reduce the overall size and cost of government. To date, only two jurisdictions have participated in the separation incentives program, which has resulted in a total of 88 positions

being abolished government-wide. The number of participants is insignificant relative to the approximate 38,000 employees in the executive branch and other jurisdictions. While these position abolishments have saved the State about $2 million annually, this amount represents a fraction of the State's budget for executive branch salaries of approximately $2 billion per year. Unless the administration or the Legislature directs or encourages more widespread use of the separation incentives program, low participation will persist and the program will remain underutilized.

Recommendations and Response

We recommended that the Departments of Human Resources Development and Budget and Finance collaborate with all government jurisdictions to ensure that proper guidelines are developed to implement the separation incentives program; ensure that employees who elect to participate in the program do not reemploy with any public jurisdictions without first forfeiting the benefits they received under Act 253; and properly monitor workforce restructuring activities of the agencies participating in the program and ensure that abolished positions are removed from appropriate budget and personnel files. We also recommended that the departments collaborate with all government jurisdictions to determine whether workforce restructuring plans are being properly implemented by the agencies; determine the overall effectiveness of the plans after implementation; and ensure that unjustified payments of special incentive retirement benefits are recovered from employees who reemploy with the State. Finally, we recommended that the Department of Human Resources Development ensure that its reports to the Legislature include a description of how the new workforce structures will more efficiently serve the needs of agencies' clients and of appropriate criteria to measure the new workforce structures' effectiveness.

The Department of Human Resources Development disagreed with both of our findings. The Department of Budget and Finance believes that it and the Department of Human Resources Development are making good faith efforts to implement and administer the separation incentives program and offered specific responses to budgetary issues. The Employees' Retirement System did not disagree with our findings but did note that it has since recovered the $7,000 special retirement overpayment.

Marion M. Higa
State Auditor
State of Hawaii

Office of the Auditor
465 South King Street, Room 500
Honolulu, Hawaii 96813
(808) 587-0800
FAX (808) 587-0830

Study of Separation Incentives Provided to Public Employees Under Act 253 of the 2000 Legislature

A Report to the Governor and the Legislature of the State of Hawaii

Submitted by

THE AUDITOR
STATE OF HAWAII

Report No. 04-04
March 2004

Foreword

This is a report of our study of separation incentives provided to public employees under Act 253 of the 2000 Legislature. This study was conducted pursuant to Section 123 of Act 253. The act requested the Auditor to conduct a study of the effects of the separation incentives program on state government.

We wish to express our appreciation for the cooperation and assistance extended to us by the Department of Human Resources Development, the Department of Budget and Finance, the Employees' Retirement System, and others whom we contacted during the course of the study.

Marion M. Higa
State Auditor

Table of Contents

Chapter 1
Introduction

Act 253, originally known as the "Civil Service Reform Act," was intended to tame an unduly cumbersome civil service system. Existing civil service workforce reduction laws were unwieldy and burdensome to administer. In particular, the Legislature found that existing laws enabled senior employees to displace junior employees, while retaining salaries of the abolished positions (referred to as "red-circling" those salaries). The workforce reduction process was neither efficient nor effective.

Other downsizing methods were also ineffective. In 1994 and 1995, early retirement was offered to eligible state employees in an attempt to downsize government. Unfortunately, the early retirement laws fostered a kind of gamesmanship that led to talented employees in critical areas voluntarily separating from state service only to be rehired on temporary appointments.

The Legislature sought to eliminate this element of gamesmanship and still provide a means for government to restructure and downsize. In 2000, the Legislature adopted Act 253, Part V, which authorizes the use of separation incentives. In so doing, it hoped to emulate the federal government's success with reduction-in-force approaches.

This study assesses public employees' participation in the separation incentives program created under this act and the program's overall impact on government. Section 123 of Act 253 directs the auditor to conduct a study of the effects of the separation incentives program on state government and submit a report not later than 20 days prior to the convening of the 2004 regular session.

Background of Separation Incentives Law

The separation incentives law was created to provide the State with the necessary tools for restructuring government. The law authorizes the state executive branch to offer voluntary severance or special retirement incentive benefits to state employees who voluntarily separate from service when their positions are identified for abolishment or when they are directly affected by a reduction-in-force (RIF) or workforce restructuring plan. The law also extends to other jurisdictions (counties, the Judiciary, Hawaii Health Systems Corporation, Office of Hawaiian Affairs, and the Legislature) the option of providing special retirement incentive benefits to their respective employees under a RIF or workforce restructuring plan. As of December 2003, only the state executive branch and the Hawaii Health Systems Corporation have participated in the separation incentives program.

Hawaii's reduction–in-force history

In 1995, with Hawaii facing a major shortfall in projected tax revenues, the governor called for immediate budget cuts across all departments. Some departments responded by issuing 90-day RIF notices to a total of 396 regular civil service employees. Because of seniority and other factors, another 104 regular and non-regular employees were affected.

These 1995 RIFs were administratively burdensome to implement and did not result in monetary savings for the State because of unemployment compensation costs and vacation payouts. In fact, the RIFs caused non-monetary losses that profoundly affected the state workforce, including lower employee morale and productivity, resentment of RIF employee placements and their displacements, disruptions of normal operations, overall reduced government efficiency, increased fear, and a few incidents of workplace violence.

Despite these negative impacts, from 1996 to 1998 the State continued to reduce its workforce by utilizing traditional downsizing methods, such as RIFs, attrition, restricted hiring, and the abolishment of vacant positions. The Legislature also identified a small number of permanent civil service positions for abolishment, which the administration carried out. From 1996 to 1998, RIFs affected a total of 92 employees. In hindsight, the Legislature found that RIFs are not an effective approach to reducing payroll costs.

In 1999, the Legislature concluded that Hawaii's and the federal government's experiences with traditionally accepted downsizing methods were parallel. Under the federal Workforce Restructuring Act of 1994 and the Omnibus Spending Act of 1996, the federal government successfully reduced its workforce size by approximately 440,000 through employee buyouts, early retirements, regular retirements, career transitions, and restricted hiring. According to the federal Office of Personnel Management, only 10 percent of the federal government downsizing was attributed to RIFs while 36 percent was attributed to employee buyouts. In a May 1996 report, the U.S. General Accounting Office concluded that cash buyouts can be highly effective restructuring tools in accomplishing major workforce reductions.

Types of benefits under the separation incentives law

The separation incentives law authorizes the state executive branch to offer either a voluntary severance benefit (cash buyout) or a special retirement incentive benefit. Elected or appointed officials and school-level personnel with the Department of Education, such as principals and teachers, are excluded. Other public jurisdictions are not authorized to offer a voluntary severance benefit, but may offer a special retirement benefit.

Voluntary severance or cash buyout is a one-time lump sum cash bonus calculated at 5 percent of the employee's base salary for every year of service worked, up to ten years, and should not exceed 50 percent of the employee's annual base salary.

A special retirement incentive can be offered to employees if they meet one of the following Employees' Retirement System criteria:

1. Ten years credited service as a contributory member and be at least 50 years old,

2. Twenty years credited service as a contributory member, irrespective of age,

3. Ten years of credited service as a noncontributory member and be at least 57 years of age, or

4. Twenty-five years of credited service as a noncontributory member, irrespective of age.

There are distinct differences between the age and service eligibility requirements under the separation incentives program and the regular service retirements. Exhibit 1.1 compares the age and service eligibility requirements for employees to retire using the special retirement incentive benefit with a regular service retirement. The special retirement incentive differs from previous early retirement benefits in that it specifically prohibits reemployment with any government jurisdiction unless all benefits are forfeited prior to reemployment.

Administration of the separation incentives law

The Department of Human Resources Development and the Department of Budget and Finance are the agencies primarily responsible for implementing and administering the separation incentives law. The departments are required to develop and administer guidelines and timeframes to assist participating agencies with implementing voluntary severance and special retirement incentive benefits under Act 253. In addition, the Department of Human Resources Development, in conjunction with the Employees' Retirement System and the Hawaii Employer-Union Health Benefits Trust Fund, ensures that informational briefings are provided to affected employees before a RIF or workforce restructuring plan is implemented.

State agencies are required to transmit to the Departments of Human Resources Development and Budget and Finance a report on positions

Exhibit 1.1
Special Incentive and Regular Service Retirement Eligibility Requirements Comparison

Eligibility Requirements	Special Incentive Retirement	Regular Service Retirement
Noncontributory	• At least 57 years old with at least 10 years of credited service • Any age with at least 25 years of credited service	• At least 55 years old with at least 30 years of credited service • At least 55 years old with at least 20 years of credited service with an age penalty if below age 62 • At least 62 years old with at least 10 years of credited service • Age 65 (if employee terminated before age 62) with 10-19 years of credited service
Contributory	• At least 50 years old and at least 10 years of credited service • Any age with at least 20 years of credited service	• At least 55 years old with at least 5 years of credited service • Any age with 25 years of service with an age penalty if below age 55

Source: Employees' Retirement System

identified for abolishment and vacated, and a list of employees who received benefits along with the benefits they received. These agencies are responsible for abolishing reported positions from the appropriate budget and personnel files.

The Department of Human Resources Development is also required to report to the Legislature on any restructuring or reengineering activities initiated under the separation incentives law within the various departments. The report should include a description of: 1) the abolished positions, 2) how the new workforce structure will more efficiently serve the needs of the agency's clients, and 3) the appropriate criteria to measure the new workforce structure's effectiveness.

Objectives

1. Assess the implementation and administration of the separation incentives provisions of Act 253 by the Department of Human Resources Development, the Department of Budget and Finance, and the Employees' Retirement System.

2. Make recommendations as appropriate.

Scope and Methodology

We collected information and data from all state and county agencies that participated in the separation incentives program in FY2000-01 through FY2002-03. Our study focused on the implementation and administration of the separation incentives provisions of Act 253 by the Departments of Human Resources Development and Budget and Finance, and the Employees' Retirement System.

We examined documents, reports, and fiscal and personnel records compiled by the Departments of Human Resources Development and Budget and Finance and the Employees' Retirement System to document employees who received either a voluntary severance benefit or special retirement incentive benefit. We also reviewed the three administrative agencies' controls to track employees who have either retired under the separation incentives law or received a severance benefit.

We assessed the Employees' Retirement System's practices and procedures of providing informational briefings to employees who are affected by a position abolishment, RIF, or workforce restructuring plan, as well as the system's ability to track those employees who received separation incentive benefits. We met with staff at the three agencies to obtain additional information on the administration of the separation incentives law.

Our work was conducted from September 2003 through December 2003 according to generally accepted government auditing standards.

This page intentionally left blank.

Chapter 2

Flawed Implementation and Poor Management of the Separation Incentives Program Minimize Its Intended Benefits

The Department of Human Resources Development and the Department of Budget and Finance failed to provide adequate guidance and oversight for the separation incentives program, resulting in noncompliance with Act 253 and no monitoring of workforce restructuring activities. Flawed implementation and poor management of the separation incentives program have minimized its intended benefits. Weak controls over the program allow its participants to reemploy with state government.

As of December 2003, the separation incentives program has done little to reduce the overall size and cost of government. In addition, the overall effectiveness of the program is unclear because the Departments of Human Resources Development and Budget and Finance have failed to properly evaluate the restructuring activities of the participating agencies.

Summary of Findings

1. The Department of Human Resources Development and the Department of Budget and Finance failed to comply with the requirements of the separation incentives law. Noncompliance results in inconsistent implementation of separation incentives programs in state government.

2. The separation incentives law has done little to reduce the overall size and cost of government.

The Departments of Human Resources Development and Budget and Finance Failed to Properly Implement and Administer the Separation Incentives Law

The Departments of Human Resources Development and Budget and Finance failed to establish a separation incentives program that ensures only eligible public employees receive either severance or special retirement benefits. Lack of guidance and oversight contribute to this condition. Both agencies have not developed guidelines for all participating agencies to follow; the participating agencies' workforce restructuring activities are not properly monitored; and there is no proof that abolished positions are being removed from the appropriate budget files as required.

Poor management has resulted in noncompliance and abuse

The limited oversight and attention given the separation incentives program by the Departments of Human Resources Development and Budget and Finance have resulted in noncompliance with the executive branch program's guidelines and the law. The departments have not established adequate controls over the separation incentives program, which allows undetected reemployment breaches to occur. The departments have also limited their involvement in administering the separation incentives guidelines to the state executive branch agencies. As a result, lack of guidance and oversight by both agencies allowed one agency, the Hawaii Health Systems Corporation, to implement a faulty separation incentives program.

Weak controls allow reemployment breaches to occur

The Department of Human Resources Development has not carried out its responsibility to monitor the "no reemployment" provision through its electronic employee records database. Act 253, Part V, requires that voluntary severance participants must return cash benefits received if reemployment occurs within five years from their separation date. Special retirement recipients must forfeit the benefits derived before reemployment with state government. In 2001, the Legislature further limited the reemployment parameters for special retirement recipients. Act 61 provides that special retirement recipients must forfeit their special benefits if they are reemployed by *any* public jurisdiction—state or county.

According to a Department of Human Resources Development official, special incentives program participants can reemploy with the State or county undetected, which diminishes the program's efficiency and savings. The department acknowledged that a loophole in its reemployment monitoring process exists, but indicated it is currently working on a solution. Until the loophole is closed, however, the Departments of Human Resources Development and Budget and Finance are not complying with the separation incentives law or guidelines.

We found one special incentive retiree who improperly reemployed with the State without first forfeiting his retirement benefits. This employee retired from the Hawaii Health Systems Corporation on September 30, 2002, electing the special incentive retirement benefit. A few months later the employee reemployed with another state employer, the University of Hawaii, in a part-time appointment from January 13, 2003, through May 31, 2003. The employee was paid approximately $4,500. At the same time, the employee continued receiving special retirement benefits of approximately $7,000 from January 13, 2003, through September 30, 2003.

The Employees' Retirement System discovered the employee's university salary information when it was finalizing the August 30, 2003, pension payroll. The Department of Human Resources Development did not know of the reemployment until notified by the Employees' Retirement System. As of September 30, 2003, the employee forfeited the special retirement payments but has not reimbursed the State approximately $7,000 in benefits already received. Even though the law does not designate a lead agency to rectify such errors, the Employees' Retirement System has requested repayment of the $7,000. As of December 12, 2003, however, the employee has not returned the money.

Until the Department of Human Resources Development monitors separation incentives program participants' reemployment with the State, improper reemployments such as this one can occur. Such improprieties result in unnecessary costs to the State.

There is no proof that abolished positions were removed from budget files

We found the Department of Budget and Finance is not removing abolished positions from its budget files as required by the separation incentives law. We reviewed budget tables for each department with positions abolished under the separation incentives law. These tables list position information (i.e., title, position number, budgeted pay amount) and should reflect the abolishment of identified positions.

Upon review, we found that the tables did not clearly indicate whether positions had been abolished. Staff from the Department of Budget and Finance explained that abolished positions are reflected in the tables as vacant, with a "0" position count and "0" funding amount. These same factors could mean the position was not funded or was transferred.

Department staff confirmed that the tables are misleading and do not clearly indicate a position has been abolished.

The Hawaii Health Systems Corporation's program violates the separation incentives law

We found that the Hawaii Health Systems Corporation has implemented a faulty separation incentives program. First, the corporation offers a separation incentive without initially identifying the employee's position for abolishment. For example, between FY2002-03 and FY2003-04, two corporation employees were offered the special retirement incentive option. They initially decided to retire but later changed their minds and rescinded their retirements. As a result, their two positions were not abolished. In effect, the employees' acceptance or decline of the employer's offer determined whether the positions were retained or abolished. This voluntary, employee-driven program contradicts the intent of the separation incentives law and does not comply with its requirements.

When asked about the voluntary nature of its program, the corporation claimed that a state mandate prohibiting RIFs and layoffs necessitated a voluntary program. However, the corporation was unable to provide evidence substantiating its belief. Indeed, if such a mandate were in place, no state agency could have used the separation incentives law.

Second, the corporation offers an unauthorized cash buyout. The law limits this incentive to state executive branch employees. Thirteen corporation employees opted to leave the corporation and accepted cash buyouts that they were not eligible to receive. The corporation should not have offered the cash incentive, an error that cost the State approximately $275,000.

Participating agencies do not receive adequate guidance and oversight

We found that the Departments of Human Resources Development and Budget and Finance do not adequately oversee and guide participating agencies. The departments have not developed program guidelines for all eligible jurisdictions. In addition, the Department of Human Resources Development is not monitoring workforce restructuring activities of agencies participating in the program.

Separation incentives program guidelines are not developed for all jurisdictions

The Departments of Human Resources Development and Budget and Finance did not attempt to develop and administer guidelines and timeframes for all public employees despite Act 253's directive to do so. The department developed guidelines only for the executive branch and provided them to other jurisdictions simply as models to follow.

The Department of Human Resources Development is not monitoring workforce restructuring activities

We found that the Department of Human Resources Development is not monitoring the workforce restructuring activities of the agencies participating in the separation incentives program. Although the separation incentives law provides that the department shall report how new workforce structures will more efficiently serve the needs of the agency's clients, the department limits its responsibility to planning and reviewing draft restructuring plans, providing separation incentives employee briefings, and removing abolished positions from its Human Resources Management System. Because it does not monitor workforce restructuring activities, officials from the department were unable to comment on agency implementation of restructuring plans.

The director of human resources development stated that the Department of Budget and Finance is in a better position to ensure that participating agencies have implemented their restructuring plans since agencies provide their annual budget requests to that department. Yet, the director of human resources development has not solicited this information from the Department of Budget and Finance. The Department of Human Resources Development's report to the Legislature failed to address this issue. So long as the efficiency and effectiveness of the workforce restructuring activities are unknown, the overall effectiveness of the separation incentives program is also unclear.

The Separation Incentives Law Has Done Little to Reduce the Overall Size and Cost of Government

The separation incentives law has fallen short of its goal of restructuring government to improve operations and realize cost savings. While the separation incentives program has resulted in some cost savings, it has not achieved an overall reduction in the size and cost of government. We also found the program's overall effectiveness is unclear because an evaluative mechanism does not exist.

Few employees have participated in the separation incentives program

Since the inception of the separation incentives program in FY2000-01 through FY2002-03, there have been very few participants. As of December 2003, workforce restructuring activities have occurred in only two jurisdictions: the executive branch and the Hawaii Health Systems Corporation. These two jurisdictions have abolished a total of 88 positions and affected 103 employees. The number of affected employees is greater than the number of abolished positions because some employees exercised their reduction-in-force rights and bumped other employees with less seniority out of their positions.

Of the 103 affected employees, 44 elected to receive a separation incentive benefit. Of the 44, 25 employees elected the cash buyout and 19 elected the special retirement incentive. Even though the program has reduced the number of positions and employees, there is little impact on the overall size of state government. The number of participants is insignificant relative to the total number of employees—approximately 38,000—in the executive branch and other jurisdictions.

Separation incentives program results in some savings, but falls short of achieving its potential

Between FY2000-01 and FY2002-03, the state executive branch saved approximately $2 million as a result of the separation incentives program. Thirty-five employees who elected either voluntary severance or special retirement incentives saved the State approximately $560,000, and 54 employees who elected to exercise their reduction-in-force rights and be placed in another position saved the State approximately $1.6 million. The $2 million in savings compounds annually.

Although $2 million in annual savings is significant, the amount is less remarkable when put in its proper context. Savings of $2 million represents 0.1 percent of the State's budget for executive branch salaries, which is approximately $2 billion per year. The program has not achieved a meaningful reduction in the overall cost of government, but more cost savings could be realized with greater participation.

In general, voluntary severance savings can be calculated by subtracting the cash buyout and vacation payout from the abolished position salary. For example, if an employee's abolished position salary was $40,000, cash buyout $20,000, and vacation payout $5,000, the savings for this position abolishment would be $15,000.

Calculating special retirement savings is more difficult since the employee will receive an ongoing retirement benefit. For the first year of retirement, the special retirement savings can generally be estimated by subtracting the vacation payout from the abolished position salary. For example, if an employee's abolished position salary was $40,000 and vacation payout $5,000, the savings for this position abolishment in the first year would be $35,000. In subsequent years, the salary savings of $40,000 would be reduced by retirement benefits paid of approximately $4,100 according to an actuarial study provided by the Employees' Retirement System. The resulting savings for subsequent years is approximately $35,900 per year.

Savings associated with employees whose positions are abolished and who exercise their RIF rights are generally the abolished position salary.

The actual savings is reduced if the employee's "red-circled" (frozen) pay is greater than the salary of the position the employee subsequently filled.

Unless agencies restructure workforces, the program's participation rate will remain low

Participation in the separation incentives program has been minimal in part because the program is voluntary. As such, state agencies and other jurisdictions are not obligated to restructure workforces, abolish positions, and implement separation incentives programs. We found no evidence of administrative directives to compel participation. Absent a directive or incentive, it is no wonder that between FY2000-01 and FY2002-03 only two state jurisdictions have implemented 12 workforce restructuring plans.

Unless the state administration or the Legislature mandates participation in the program and the development of more restructuring plans, this program will continue to experience an extremely low participation rate.

Separation incentives program lacks a mechanism to evaluate the overall impact

The purpose of the separation incentives law is to provide the tools necessary to restructure government services in the least disruptive manner. However, there is no mechanism in the law to measure and evaluate the overall impact of the separation incentives programs. As a result, no formal evaluation has been done to determine whether restructuring plans have been successfully implemented. The Department of Human Resources Development and state executive branch agencies have independently estimated costs or savings related to the state executive branch position abolishments and program participants; however, a lack of standardized criteria makes these estimates disparate. Until a formal evaluation process is implemented, the results and overall effectiveness of the program will be unclear.

Program reporting requirements are flawed

The law requires that the Department of Human Resources Development report to the Legislature on any restructuring or reengineering activities within the state executive branch departments initiated as a consequence of the separation incentives law. This report should include a description of abolished positions, how new workforce structures will more efficiently serve agency client needs, and criteria to measure the new structure's effectiveness.

There are two problems with the current requirements. First, there are no reporting requirements for the other jurisdictions (the counties, Judiciary, Hawaii Health Systems Corporation, Office of Hawaiian Affairs, and state and county legislative branches) that may develop a separation incentives program. These agencies do not have to report their restructuring activities to an independent source and reviewer. Second, there is no mechanism for any state or county agency to ensure that restructuring plans are complete, properly implemented, and evaluated to determine the success of the reorganization and the costs or savings realized. As a result, state and county agencies are not held accountable for their restructuring plans and the true effect of the separation incentives law is unclear.

Conclusion

The Departments of Human Resources Development and Budget and Finance have failed to properly implement and adequately administer the separation incentives program. These deficiencies have resulted in noncompliance with the program's law. By not establishing proper management controls and providing proper direction and oversight for participating jurisdictions, the administering agencies have allowed such jurisdictions to implement flawed programs. Reemployment with the State after receiving separation incentive benefits as well as ineligible participation in the separation incentives program will continue unless appropriate controls are adopted and enforced. In addition, the Departments of Human Resources Development and Budget and Finance must develop guidelines to assist all public jurisdictions with program implementation.

Because few workforce restructuring activities have taken place since the law was passed and an insignificant number of employees have participated in the separation incentives program, the program has yielded very little savings relative to the overall cost of government. Unless the administration or the Legislature directs or encourages more widespread use of the separation incentives program, low participation will persist and the program will remain underutilized. Even with this program, the intended goal of reducing the overall size and cost of government remains elusive.

Recommendations

1. The Departments of Human Resources Development and Budget and Finance should:

    a. Collaborate with all government jurisdictions to ensure that proper guidelines are developed to implement the separation incentives program;

    b. Ensure that employees who elect to participate in the separation incentives program do not reemploy with any public jurisdictions without first forfeiting the benefits received under Act 253;

c. Properly monitor the workforce restructuring activities of the agencies participating in the separation incentives program and ensure that abolished positions are removed from appropriate budget and personnel files;

d. Collaborate with all government jurisdictions to determine whether workforce restructuring plans are being properly implemented by the agencies that submit them and the overall effectiveness of the plans after implementation; and

e. Ensure that unjustified payments of special incentive retirement benefits are recovered from employees who reemploy with any public jurisdiction.

2. The Department of Human Resources Development should ensure that its reports to the Legislature include a description of how the new workforce structures will more efficiently serve the needs of agencies' clients and of appropriate criteria to measure the new workforce structures' effectiveness.

This page intentionally left blank.

Responses of the Affected Agencies

Comments on Agency Responses

On February 19, 2004, we transmitted drafts of this report to the Department of Human Resources Development, Department of Budget and Finance, and the Employees' Retirement System. A copy of the transmittal letter sent to the Department of Human Resources Development is included as Attachment 1. Similar letters were sent to the other agencies. A copy of the Department of Human Resources Development, Department of Budget and Finance, and Employees' Retirement System responses are included as Attachments 2, 3, and 4, respectively.

The Employees' Retirement System did not disagree with the findings and recommendations of our audit but did note that it has since collected the $7,000 special retirement overpayment.

The Department of Budget and Finance believes that both Departments of Human Resources Development and Budget and Finance have made good faith efforts to implement and administer the separation incentives program. The department believes that there is no legal basis for our finding that separation incentives program guidelines have not been developed for all jurisdictions. The department maintains that it would be inappropriate for the state executive branch to oversee the administration of other jurisdictions' separation incentives programs in light of the doctrine of separation of powers and home rule.

We acknowledge the department's concerns and the potential jurisdictional issues that this law presents. However, Section 120 of Act 253, Session Laws of Hawaii 2000, specifically states that the Department of Human Resources Development and the Department of Budget and Finance shall *develop* and *administe*r guidelines and timeframes for *participating agencies* to implement the voluntary separation and special retirement incentive benefits. *Participating agencies* is not defined in Act 253, Part V, and Section 120 does not specify that guidelines are to be developed and administered for only participating *executive branch* agencies. As such, it is our belief that the Department of Human Resources Development and the Department of Budget and Finance should have developed guidelines for any and all agencies participating in the separation incentives program.

The Department of Budget and Finance also states that it was not the intent of Act 253 to reduce the overall size and cost of government. However, according to the State of Hawaii Separation Incentives

Program Guidelines (dated August 30, 2000) submitted to the Legislature by both the Departments of Human Resources Development and Budget and Finance, two key objectives of the separation incentives program are to:

1. Implement restructuring plans which may include reducing the size of the state government workforce; and

2. Achieve permanent cost-predictive and cost-contained savings via separation incentives.

More importantly, testimony presented by both departments provided that "the separation incentives law is modeled after the federal government's highly successful voluntary separation incentives program utilized in recent years to permanently reduce personnel costs and the size of the federal workforce."

The Department of Human Resources Development also disagreed with our findings. With respect to our finding that the Hawaii Health System Corporation (HHSC) implemented a faulty separation incentives program, the Department of Human Resources Development stated that HHSC and all other Hawaii public employers are responsible for the development and administration of their own separation incentives programs and not the Departments of Human Resources Development and Budget and Finance. We disagree with the department's narrow interpretation of the law. As pointed out earlier, Section 120 of Act 253 does not limit the department's roles and responsibilities only to executive branch agencies. Without clarifying language, *agency* refers to *any* agency, executive branch or otherwise.

Further, Section 120 of Act 253 requires the Department of Human Resources Development to work cooperatively with the Employees' Retirement System and the Public Employees Health Fund to provide informational briefings prior to the implementation of *any* workforce restructuring plan. All state, county, and other jurisdiction employees belong to the retirement system and health fund, not just executive branch employees. This requirement demonstrates that the Department of Human Resources Development's involvement was not limited to executive branch agencies. Accordingly, we stand on our findings.

ATTACHMENT 1

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917

MARION M. HIGA
State Auditor

(808) 587-0800
FAX: (808) 587-0830

February 19, 2004

COPY

The Honorable Kathleen Watanabe
Director
Department of Human Resources Development
Leiopapa a Kamehameha Building
235 South Beretania Street, 14^{th} Floor
Honolulu, Hawaii 96813

Dear Ms. Watanabe:

Enclosed for your information are three copies, numbered 6 to 8 of our confidential draft report, *Study of Separation Incentives Provided to Public Employees Under Act 253 of the 2000 Legislature*. We ask that you telephone us by Monday, February 23, 2004, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Wednesday, February 25, 2004.

The Department of Budget and Finance, Employees' Retirement System, Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

Marion M. Higa

Marion M. Higa
State Auditor

Enclosures

ATTACHMENT 2

LINDA LINGLE
GOVERNOR OF HAWAII

KATHLEEN N. A. WATANABE
DIRECTOR

JANICE T. KEMP
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF HUMAN RESOURCES DEVELOPMENT
235 S. BERETANIA STREET
HONOLULU, HAWAII 96813-2437

February 26, 2004

RECEIVED
FEB 26 2 49 PM '04
OFC. OF THE AUDITOR
STATE OF HAWAII

Ms. Marion M. Higa
State Auditor
Office of the Auditor
465 S. King Street, Room 500
Honolulu, HI 96813-2917

Dear Ms. Higa:

Thank you for the opportunity to review and provide our final comments on your confidential draft report, *Study of Separation Incentives Provided to Public Employees Under Act 254 of the 2000 Legislature.*

We are transmitting the attached Department of Human Resources Development's final comments for your review and consideration.

Very truly yours,

Kathleen N. A. Watanabe

Kathleen N. A. Watanabe
Director

Attachment

c: Hon. Linda Lingle, Govenor
Hon. Georgina Kawamura, B&F

RESPONSE TO DRAFT REPORT ON STUDY OF SEPARATION INCENTIVES PROVIDED TO PUBLIC EMPLOYEES UNDER ACT 253 OF THE 2000 LEGISLATURE

BY OFFICE OF AUDITOR

Submitted by Kathleen N.A. Watanabe, Director
Department of Human Resources Development

February 26, 2004

We respectfully submit our responses to the two (2) major findings stated in the draft report on the *Study of Separation Incentives Provided to Public Employees under Act 253 of the 2000 Legislature*.

Summary Finding 1: The Departments of Human Resources Development and Budget and Finance failed to properly implement and administer the separation incentives law. Noncompliance results in inconsistent implementation of separation incentives programs in state government.

HRD Reply

The Auditor believes that, "the Departments of Human Resources Development and Budget and Finance are the agencies primarily responsible for implementing and administering the separation incentives law."

We respectively disagree that the Departments of Human Resources Development and Budget and Finance are responsible for the administrative oversight of all separation incentives activities among all Hawaii public employer jurisdictions for the following reasons earlier provided to the Auditor.

1. The State Executive Branch administers a civil service personnel system separate and apart from other Hawaii public jurisdictions.[1] Hiring and retention (including Reduction-in-Force) decisions of the State Executive Branch are independent of those made by each separate Hawaii public jurisdiction. Therefore, workforce restructuring decisions made by the Executive Branch do not necessarily impact the workforces of the other jurisdictions.

[1] Section 26-5 Department of human resources development, Hawaii Revised Statutes

Further, Reduction-in-Force (RIF) decisions made by the Executive Branch do not necessarily impact workforces of the other Hawaii public jurisdictions. That is, the RIF processes are self-contained within each jurisdiction. Unsuccessful RIF placement searches result in the termination of the RIF affected employees from the Executive Branch. There is no RIF cross-over between the Hawaii public jurisdictions.

2. The Departments of Human Resources Development (HRD) and Budget and Finance (B & F), respectively, do not have legal oversight of human resources management and budgetary and fiscal control in the other Hawaii public employer jurisdictions, including but not limited to, Hawaii Health Systems Corporation (HHSC), Office of Hawaiian Affairs (OHA)[2], Legislative Branch, The Judiciary, Board of Education and Board of Regent appointees, City and County of Honolulu, and the Counties of Hawaii, Kauai and Maui.

3. HRD and B & F jointly issued its draft Separation Incentives Program Guidelines (Guidelines) in August 2000, followed by the final Guidelines issued on July 6, 2001. Copies of the Guidelines were provided to the 2001 and 2002 Legislatures and separate jurisdictions upon request. The Guidelines clearly defined participating agencies for the Executive Branch and identified those agencies specifically excluded from participation such as the HSSC, OHA, The Judiciary and Legislative Branch.

4. Section 122[3] of ACT 253 authorizes optional participation by all jurisdictions that are separate from the Executive Branch. HHSC is a public corporation and administers a separation personnel system from the Executive Branch. Further, by statutory definition under Section 113 of ACT 253, HHSC[4] is a separation jurisdiction from the Executive Branch[5] for purposes of administering Part V of ACT 253.

   Section 122 of ACT 253 further states that, "the Chief Executive Officer or other appropriate authority of the respective jurisdictions shall ensure that approval of its respective legislative body is obtained, if required, before

---

2 OHA is an independent entity from the Executive Branch pursuant to Section 10-4, Hawaii Revised Statutes.

3 Section 122 of ACT 253 provides authority to HHSC to "opt to provide the special retirement incentive benefit under section 115 to the respective employees under a workforce restructuring plan; provided that the special retirement incentive is in lieu of any voluntary severance benefit that may be offered under its plan and is consistent with all of the provisions in section 115. All references to the State in section 115 shall include the jurisdiction opting to provide the special retirement incentive benefit."

4 "Jurisdiction" means the city and county of Honolulu, the county of Hawaii, the county of Maui, the county of Kauai, the judiciary, the Hawaii health systems corporation, the office of Hawaiian affairs, and the legislative branches of the State and county governments.

5 "Executive branch" includes the department of education, and the University of Hawaii, but excludes the Hawaii health systems corporation which is considered a separate jurisdiction under this part.

offering the special retirement incentive under section 115." Consequently, HHSC and all other Hawaii public employers are responsible for the development and administration of their own Separation Incentives programs and not the HRD and B & F.

5. The Legislature's passage of ACT 61, SLH 2001 impacted the potential effectiveness of the Special Retirement Incentives authorized by Part V of ACT 253, and the administration of the Separation Incentives Program for the Executive Branch. By promulgating a new permanent statute in Chapter 88, HRS, ACT 61 prohibits any ACT 253 retirant from working in any Hawaii public jurisdiction, including temporary employment (less than 19.5 hours per week or more than 89 consecutive days) enjoyed by all other retirants. Therefore, ACT 61, SLH 2001, nullified the purpose and overall effectiveness of the Separation Incentives Law as originally intended by the Legislature.

6. As cited in the 2002 Legislative Report on Separation Incentives submitted to the 2002 Legislature, HRD stated its concerns to the Legislature with ACT 253 retirants compliance provision required by ACT 61, SLH 2001. That is, HRD informed the Legislature that, like all other Hawaii public employer jurisdictions, we relied on the Employees' Retirement System to design a methodology to ensure that the State Executive Branch does not employ any ACT 253 retirants for all part-time and temporary employment.

   At present, however, we continue to face administrative difficulty in complying with the ACT 61 provisions across all Hawaii public jurisdictions. Under the current administration, "No-Hire" lists, that include former employees who resigned from the Executive Branch with their election of Separation Incentives Benefits, will be routinely issued to all executive departments and other Hawaii public jurisdictions. Nevertheless, the cited finding of the ACT 253 retirant from the HHSC being subsequently employed by the University of Hawaii is an example of the compliance difficulty that was foreseen by all Hawaii public employer jurisdictions when they learned of ACT 61's passage.

7. With respect to the Auditor's various findings that, "the HHSC has implemented a faulty separation incentives program", "the Departments of Human Resources Development and Budget and Finance did not attempt to develop and administer guidelines and timeframes for all public employees despite Act 253's directive to do so", and "Department of Human Resources Development is not monitoring the workforce restructuring activities participating in the separation incentives program", we strongly disagree with the Auditor's conclusion that HRD and B & F are responsible to oversee and guide participating agencies **outside** of the Executive Branch.

We further disagree with the Auditor's conclusion that the HRD and B & F failed to develop Separation Incentives Program Guidelines and monitor workforce restructuring plans for participating agencies.

These findings ignore that ACT 253, the Omnibus Civil Service Modernization law, repealed provisions[6] that previously required uniform administration of civil service personnel systems among all Hawaii public employer jurisdictions. The underlying principle of "home rule" by each separate employer jurisdiction was confirmed and recognized through the systemic changes that were mandated by ACT 253.

Summary Finding 2: The separation incentives law has done little to reduce the overall size and cost of government.

HRD Reply

1, The Auditor believes that, "the separation incentives law has fallen short of its goal of restructuring government to improve operations and realize cost savings. While the separations incentives program has resulted in some cost savings, it has not achieved an overall reduction in the size and cost of government. "

We respectfully disagree. The primary purpose of the Separation Incentives law, which was an administrative measure, is to provide for the use of separation incentives as **voluntary management tools** to facilitate the restructuring of programs and services and to minimize the negative impact of Reduction in Force to affected employees and impacted programs in the Executive Branch.

These enabling provisions did not specifically mandate an overall reduction in the size and cost of government. Moreover, the various provisions of Hawaii's Separation Incentives law further ensure that any reduction in workforce and funding in the Executive Branch are permanent, cost-predictive and cost-contained.

The use of separation incentives in the Executive Branch have been limited to the abolishment of 80 civil service positions and 95 RIF-affected employees during October 2000 through December 31, 2003, as a result of 13 workforce restructuring plans.

[6] Section 76-2, HRS repealed by ACT 253.

As a result of the Separation Incentives Law, the Executive Branch realized the following cost savings:

- First Year Savings (less Voluntary Severance Benefits, Vacation Benefits Payout) for 35 Employees who elected Separation Incentives: **$559,121.00**

- SECOND YEAR & SUBSEQUENT YEARS' SEPARATION INCENTIVES SAVINGS: **$1,332,024.00**

Total RIF Placement Costs: **$1,632,636.00**

From year 2, permanent cost savings from 80 abolished positions will be: $2,815,800.00

Thank you for the opportunity to provide our final comments and concerns.

Respectfully submitted,

Kathleen N. A. Watanabe

Kathleen N. A. Watanabe, Director
Department of Human Resources
Development

ATTACHMENT 3

LINDA LINGLE
GOVERNOR

GEORGINA K. KAWAMURA
DIRECTOR

STANLEY SHIRAKI
ACTING DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF BUDGET AND FINANCE
P.O. BOX 150
HONOLULU, HAWAII 96810-0150

EMPLOYEES' RETIREMENT SYSTEM
HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
OFFICE OF THE PUBLIC DEFENDER
PUBLIC UTILITIES COMMISSION

ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION

February 25, 2004

RECEIVED
FEB 25 3 44 PM '04
OFC. OF THE AUDITOR
STATE OF HAWAII

Ms. Marion M. Higa, State Auditor
Office of the Auditor
465 South King Street, Room 500
Honolulu, Hawaii 96813-2917

Dear Ms. Higa:

Subject: Response to Auditor's "Study of Separation Incentives Provided to Public Employees Under Act 253 of the 2000 Legislature"

Thank you for the opportunity to provide comments on the "Study of Separation Incentives Provided to Public Employees Under Act 253 and the 2000 Legislature." The report cites the Departments of Human Resources Development's (DHRD) and Budget and Finance's (B&F) failure to properly implement and administer the Separation Incentives program. We believe that both departments made good faith efforts and address the following points as they relate to budget issues.

Finding: There is no proof that abolished positions were removed from budget files.

As required by Act 253, B&F ensures that position counts and funds are deleted from the budget files. We also coordinate with DHRD to ensure that the positions are abolished from personnel files. However, to address the concern that "0" position count and "0" funding amount in the budget files could have another meaning, we have revised our guidelines to require "abolished" and the date of abolishment to be inserted in the incumbent name field in the budget details.

No. 1 Capitol District Building, 250 S. Hotel Street, Honolulu, Hawaii 96813

Finding: Separation incentives program (SIP) guidelines are not developed for all jurisdictions.

There is no legal basis for this finding that presumes that DHRD and B&F were required to develop a statewide program. It is clear that Act 253, Section 112, " . . . authorizes the ***state executive branch*** to offer a voluntary severance or a special retirement incentive . . ." program while other ***"jurisdictions,"*** as defined in Section 113, are only provided an option to provide a separation incentive program to their respective employees. Further, Section 120 requires DHRD and B&F to develop and administer guidelines for participating ***"agencies"*** of the Executive Branch and not ***"jurisdictions."***

More importantly, it would be inappropriate for the State Executive Branch to oversee the administration of other jurisdictions' separation incentive programs in view of separation of power and home rule.

Finding: The Separation Incentives law has done little to reduce the overall size and cost of government.

It was not the intent of Act 253 to reduce the overall size and cost of government. Section 112 clearly states that separation incentives " . . . provide the tools necessary to facilitate the restructuring of government . . ."

Act 253 clearly establishes separate jurisdictions that would develop and implement civil service reform as appropriate for their personnel. It does not require DHRD and B&F to ensure compliance of all jurisdictions, but instead establishes a framework and provides tools that can be used by each jurisdiction to address their specific needs. Finally, Act 253 does not intend nor mandate the reduction in size of State government.

Aloha,

Georgina K Kawamura

GEORGINA K. KAWAMURA
Director of Finance

ATTACHMENT 4

LINDA LINGLE
GOVERNOR

STATE OF HAWAII
EMPLOYEES' RETIREMENT SYSTEM

February 25, 2004

RECEIVED
FEB 26 8 47 AM '04
OFC. OF THE AUDITOR
STATE OF HAWAII

Ms. Marion M. Higa
State Auditor
Office of the Auditor
465 S. King Street, Room 500
Honolulu, Hawaii 96813

Dear Ms. Higa:

Thank you for the opportunity to comment on your draft report on the ***Study of Separation Incentives Provided to Public Employees Under Act 253 of the 2000 Legislature.***

The report indicates that the forfeited special retirement pay of approximately $7,000 was not repaid by the individual as of December 12, 2003. However, we wanted to inform you that shortly thereafter, the ERS received the required repayment amount on December 20, 2003.

We appreciate the opportunity to provide this update to the draft report. Please call me or David Shimabukuro, ERS Administrator, at 586-1700 should you have any questions.

Very truly yours,

Henry Beerman
Chair, Audit Committee
ERS Board of Trustees

City Financial Tower • 201 Merchant Street, Suite 1400 • Honolulu, Hawaii 96813-2980
Telephone (808) 586-1660 • Fax (808) 586-1677 • http://www2.state.hi.us/ers