PERFORMANCE AUDIT

DEPARTMENT OF ADMINISTRATION

Personnel Division

Report to the Arizona Legislature
By the Auditor General
October 1993
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October 14, 1993

Members of the Arizona Legislature

The Honorable Fife Symington, Governor

Mr. J. Elliott Hibbs, Director
Department of Administration

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Department of Administration, Personnel Division. This report is in response to a December 13, 1991 resolution of the Joint Legislative Oversight Committee and is the first of six audits scheduled on the Department.

To meet the needs of its users the Personnel Division must alter the manner in which personnel services are provided. Our audit work found that in the most important service areas — hiring, classification, compensation, and benefits — Arizona's current personnel system does not respond to its users' needs. The Federal Government and many other state and local governments are examining or discarding personnel systems that rely on extensive rules and restrictions and are building systems that offer the flexibility and responsiveness needed to provide efficient, effective service.

My staff and I will be pleased to discuss or clarify items in the report.

This report will be released to the public on October 15, 1993.

Sincerely,

Douglas R. Norton
Auditor General

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SUMMARY

The Office of the Auditor General has conducted a performance audit and Sunset Review of the Department of Administration, Personnel Division, pursuant to a December 13, 1991, resolution of the Joint Legislative Oversight Committee. The audit was conducted as part of the Sunset Review set forth in Arizona Revised Statutes (A.R.S.) §§41-2951 through 41-2957, and is the first of six audits scheduled on the Department.

In order to meet the needs of its users, Arizona must significantly revise the manner in which personnel services are provided. Our audit work found that in the most important service areas -- hiring, classification, compensation, and benefits -- Arizona's current personnel system does not respond to its user's needs. The Federal Government and many other state and local governments are examining or discarding personnel systems that rely on extensive rules and restrictions in favor of systems offering the flexibility and responsiveness needed to provide efficient, effective service.

The State Needs To Redesign Its Outmoded Hiring System (see pages 5 through 12)

Currently, Arizona's hiring system can deter the best candidates from entering State service. The hiring lists provided by Personnel often contain unqualified or unavailable candidates. Some hiring supervisors stated that it was often difficult to find even one qualified, available applicant on lists submitted to them. In addition, the Division requires agencies to follow policies that are often counterproductive to effective hiring. For example, we identified one case where a supervisor was required to offer an interview to a candidate who did not speak English for a position that involved working with the public.

A comprehensive reform effort is needed to change Arizona's hiring system to allow agencies increased flexibility and service. Such reform will require revision of rules and statutes that restrict agencies' hiring options. In addition, more immediate changes in the Division's operating practices are also needed, including the use of supplemental applications, increased participation of agency supervisors in candidate evaluations, and recruiting at colleges and job fairs.

DOA Needs To Address Fundamental Problems With The State's Classification System (see pages 13 through 17)

Arizona's classification system is not being properly maintained or managed. While positions should be reviewed periodically to ensure that job duties, qualifications, and compensation are still appropriate, in the last 5 years, the Personnel Division has conducted reviews of only 22 percent of the 1,500 classifications in State government.

According to DOA officials, regular classification reviews were discontinued because there was not enough funding to implement salary upgrades which often result from such reviews. However, failure to maintain the system hampers the State's recruitment efforts, and results in inappropriate employee compensation. While DOA is considering significant changes to the classification system, their efforts may be premature, particularly until an assessment of needed changes is developed and funding issues are addressed.

DOA Should Improve Efforts To Inform Decision Makers On Salary Issues (see pages 19 through 23)

Although State employees are an essential resource of State government, employee salaries have not remained competitive. While State salaries were only 7 percent behind the market in 1988, lack of salary increases has now widened the gap to over 22 percent. As a result, State agencies have difficulty attracting and retaining high-quality employees. While DOA is responsible for presenting salary recommendations to the Legislature, it has based these recommendations on available funding rather than presenting the results of its analysis to policymakers and allowing them to determine the course of action. As the State's expert on compensation, DOA needs to provide the Governor and Legislature with timely, objective, and comprehensive reports detailing various alternatives.

DOA Needs To More Proactively Manage Its Employee Health Benefits Program (see pages 25 through 30)

The Personnel Division needs to more proactively manage State employee health care insurance benefits. In 1992, in an effort to meet the Governor's demand that there be no increases in State funding for employee health care insurance, the Division made several controversial decisions. These decisions resulted in increased costs and/or reduced services for a number of current State employees and retirees alike. Further, the decisions were made with little input from the Legislature or State employees. To prevent similar problems from occurring in the future, the Personnel Division needs to ensure the State's health care needs are defined in conjunction with the Legislature and State employees; that usage is monitored; and that its Request for Proposals is specific. Further, whenever a new contract is awarded, DOA needs to ensure that employees are adequately notified, and that the carrier's performance is monitored.

DOA Should Implement Mechanisms To Curb Escalating Health Care Benefit Costs (see pages 31 through 36)

With State employee health benefits costing $168 million annually, and continuing to rise, DOA needs to adopt measures to curb these costs. DOA should consider implementing cost containment measures (such as comprehensive wellness programs and eligibility audits) that are utilized in other states and private industry. In addition, it should monitor State health care expenditures to target costly areas needing additional efforts.

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INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a performance audit and Sunset Review of the Department of Administration, Personnel Division, pursuant to a December 13, 1991 resolution of the Joint Legislative Oversight Committee. The audit was conducted as part of the Sunset Review set forth in A.R.S. §§41-2951 through 41-2957, and is the first of six audits scheduled on the Department.

Reform Of The Personnel System Is Needed To Ensure A Balance Of Fairness Against Efficiency And Effectiveness

> *"The primary organizational problem personnel management faces is that of balancing the goals of protection and efficiency. Should public administration be organized to protect employees from the "adverse" consequences of political patronage, or to maximize the efficiency of service delivery?"*[1]

In order to meet the needs of its users, Arizona must significantly revise the manner in which personnel services are provided. The basic principles of a civil service system are to ensure fairness and equality. However, recent trends in government have been to make personnel systems more responsive to user needs while continuing to uphold these principles.

Despite these trends, Arizona's personnel system is not responsive to its users in several important service areas. Although some efforts are being taken to change the system, a comprehensive approach will be necessary for effective reform.

Civil Service Designed To Ensure Fairness

Civil service or "merit" systems are comprised of the laws and rules developed to uphold principles of fairness, equality, and open competition in all areas of public sector personnel management. More than 25 years ago, Arizona established a merit system for State employees under a centralized personnel authority. This system included provisions for selection decisions based on applicant qualifications, fair and open competition for positions, evaluations of employee performance, the creation of a salary plan and a system of classifying positions, establishment of employee

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1. *Daley, D. 1990. "Organization of the Personnel Function: The New Patronage and Decentralization."* Public Personnel Administration Problems and Prospects. Englewood Cliffs, N.J.: Prentice Hall, pp. 21-37.

grievance procedures, and other measures designed to ensure employees receive fair and equitable treatment in all aspects of personnel management.

Recent Efforts Designed To Create More Responsive Personnel Systems

Although merit system principles continue to have broad-based acceptance, civil service laws and rules that were often enacted decades ago are increasingly seen as straightjackets which prevent systems from being efficient and flexible, as is demanded by economic and social conditions in today's workplace. These systems were characterized more than 45 years ago as the "*triumph of technique over purpose,*" because public personnel managers became so enamored of the techniques by which their work could be done that they lost sight of what they were supposed to do. As a result, instead of facilitating the organization's work and mission, public personnel offices often assume a policing function that hinders effective management.

This situation has led the Federal government, as well as many states and local governments, to examine and discard personnel systems that rely on extensive rules and restrictions, and build systems that are flexible and responsive. A 1993 survey by the National Association of State Personnel Executives found 33 of the 48 states responding (including Arizona) are undergoing some form of personnel reform, with seven states embarking on extensive reform of their civil service. These "reformed" public personnel systems operate more as customer service organizations. For example, the State of Washington recently enacted legislation that changes the civil service system objective from control to customer service. Minnesota also concluded that its 50-year old personnel system "*...is too complex and unresponsive to meet the needs of government and the people it serves*" and has initiated efforts to increase their system's flexibility and decentralize many decision-making responsibilities to agencies.

Arizona's System Unresponsive In Several Important Areas

The characterization "*triumph of technique over purpose*" is clearly applicable to the Arizona personnel system. Our audit work, presented in Findings I through V of this report, suggests that in the most important service areas -- hiring, classification, compensation and benefits -- DOA is not responsive to the needs of its users. This includes a broad definition of users, from agency management, to individual employees, to the Legislature. A logical conclusion about the role of the Personnel Division can be drawn from the problems we identify in this report. In those areas in which the Division should be active, providing services they are best suited for and communicating needs (i.e. classification, compensation, and benefits), DOA officials, through conscious policy decisions or neglect, have been passive, thereby failing to meet users' needs. Conversely, in the area of hiring, where users (agencies) desire

limited involvement by Personnel in the form of advice and direction, DOA has chosen to take a strong and active role. This role includes establishing and enforcing rules that significantly limit agency administrators' decision making in the selection of their single most important resource: employees. These facts suggest a system that will require more than just minor changes to correct.

Significant Reforms Are Necessary

Currently, DOA is taking some steps to change its system. However, recent experiences in other states suggest that more substantial reform efforts will be necessary in Arizona.

Based primarily on the recommendations of the 1992 SLIM evaluation of the Personnel Division, DOA has initiated efforts to improve the provision of personnel services. These include:

- The creation of a task team comprised of Personnel Division and State agency representatives, charged with redesigning the State hiring process.
- A study of the current job evaluation methodology utilized in the State's classification system.
- The formulation of a strategic plan for future personnel services.

It is too early to determine the value of these projects, because at the time of this writing, they are either incomplete or their conclusions and recommendations remain in draft form. However, these efforts appear fragmented since there is little or no coordination between the projects, although they share many common goals. Further, some analysts of public personnel reform would characterize these efforts as "*tinkering at the margins,*" and suggest that to effectively change Personnel's role, more meaningful reforms will be necessary.

Audit Scope

Our audit report of the Department of Administration's Personnel Division presents findings and recommendations in five areas:

- The need for improvement in recruiting State employees
- The need to strengthen the State's current employee classification system

- The need for improvement in employee compensation practices
- The need to strengthen the health care benefits process
- The need for improvement in the area of health care cost containment

This audit was conducted in accordance with government auditing standards.

The Auditor General and staff express appreciation to the Director and staff of the Department of Administration and its Personnel Division for their cooperation and assistance throughout the audit.

FINDING I

THE STATE NEEDS TO REDESIGN ITS OUTMODED HIRING SYSTEM

"Government is a service business. It doesn't produce a product nor does it depend principally upon technology to accomplish results. It depends largely upon people: providing services, making policy judgements, consulting with elected representatives and citizens on what services should be provided. Government probably more than almost any other business, is dependent upon the quality, the judgement, and the motivation of the people who work on the front lines."[1]

Arizona's hiring system should enable the State to attract and hire the very best of those people interested in State service. The current hiring system falls short of this goal and may actually impede agencies' abilities to hire the best applicants. The solution is a system overhaul -- one which will include significant changes in the way Personnel does business, major rule revisions, and the possibility of statutory change. Until the system is redesigned, DOA Personnel should use all available means to provide better service and increase agency participation in the current hiring process.

State Hiring Process Has A Multitude Of Problems

The State hiring system can deter the best candidates from obtaining jobs. According to hiring supervisors, the hiring lists provided by Personnel often contain unqualified candidates. Additionally, most agencies are forced to operate within a maze of rules and policies that at times border on the ridiculous. Others have been able to get DOA's authorization to circumvent policies that hinder effective hiring decisions. Some agencies, frustrated with the centralized hiring services, have obtained authority to perform the hiring functions themselves.

Hiring process overview - The Employment Section in DOA Personnel provides employment services to most State agencies, and its primary product is a hiring list. When a supervisor becomes aware of a vacancy, he or she submits a requisition to Personnel. If there is an existing register of candidates for the position, Personnel generates a hiring list from the register, sometimes performing additional screening to identify special qualifications. When no register exists, a Personnel Analyst will advertise the position, screen each application to determine whether minimum qualifications are

1. *The Washington State Commission for Efficiency and Accountability in Government.* Workforce 2000 Personnel System Study, Final Report. March 1990, page 1.

met, and then give numerical scores to those applicants meeting the qualifications.[1] The top seven scoring candidates will be placed on a hiring list and sent to the supervisor.[2] The list is intended to provide the supervisor with a small group of candidates best qualified for the position.

Hiring supervisors are generally dissatisfied with the results of this process. In a survey of hiring supervisors conducted by the Human Resources Hiring Process Task Team,[3] when asked, "*How would you rate the present hiring process in meeting your needs*", 50 percent of the 258 hiring supervisors responding rated it as poor or below average, while 37 percent rated it as average, and less than 7 percent rated it as either above average or excellent.

Hiring lists contain unsuitable candidates - After waiting up to eight weeks for a hiring list, supervisors often find candidates unsuitable. During our audit work, many supervisors conveyed a variety of problems with the lists, such as: the candidates are unqualified, unavailable, or uninterested in the job; and the lists may be months old and contain candidates who have been hired, or were previously interviewed and rejected.

Due to the lack of suitable candidates on the list and their inability to review additional applications, some supervisors have felt forced to hire candidates who they felt were unqualified for the job. For example, we tracked the outcome of 24 hiring lists generated between October 1992 and March 1993.[4] Of the 24 positions, 3 were filled with a person the supervisor felt was unqualified to do the job. The three positions included an Eligibility Interviewer, a Training Officer, and a Transportation Engineering Specialist who the supervisor said did not have appropriate roadway design experience. Two supervisors canceled requisitions, preferring to leave positions vacant rather than to hire from the list. Other supervisors expressed relief that they had been able to find one qualified, available person from the list provided. In fact, 17 of the 24 supervisors would have reviewed the applications of additional applicants if they had the ability.

Presented below are comments made during our telephone survey by different supervisors regarding the quality of candidates.

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1. Approximately 80 percent of job candidates meeting the minimum qualifications are scored by Personnel Analysts. The remainder are scored through written examination or skills declaration.

2. The hiring list may have more than seven candidates if groups of candidates have equal scores. For example, if 5 candidates score 90 and 10 score 80, the list will contain all 15 candidates because all equally scoring candidates must appear.

3. The task team resulted from a Project SLIM study that identified significant inefficiencies in the hiring system. The multi-agency team is designing hiring process changes to improve efficiency and service to agencies.

4. The sample was designed to ensure a broad mix of position types, State agencies, and Personnel Analysts. The 24 hiring lists selected involved 9 different job series -- 10 different grade levels within grades 9 through 24, 11 agencies, and 9 different Personnel Analysts.

- *"Usually I am grasping at straws to find even one marginally qualified applicant."*

- Unqualified candidates get on the hiring list for a job that involves complicated and technical decision making. *"We have actually had people beg to be fired because they were so unqualified to do the job."*

- When conducting interviews for a Public Assistance Eligibility Interviewer position, the supervisor asked the candidate what was her greatest work accomplishment. The candidate responded that it was when she finally was able to get an ice cream cone made without the ice cream falling sideways. The supervisor said to us, *"these are the type of people I have to interview."*

Enforcement of ineffective policies negatively impacts agencies - Personnel requires that most hiring supervisors follow existing rules or policies even when they are counterproductive or not in the agency's best interest. For example:

- We identified one case where, in order to get a list of additional candidates, a supervisor was required to offer an interview to a candidate that did not speak English. The services of a translator were necessary.

- In another case, a supervisor had only a few available candidates on the list and because all of them worked for his agency, he was aware of their qualifications. He contacted Personnel and told them these people were not qualified for the job. According to the supervisor, he was told that it did not matter whether he thought they were qualified--based on written documents supplied by the candidates, they were qualified. Personnel refused to provide additional names.

- One manager tried to hire a current employee into a supervisory position. The employee had managerial experience in a related field, but not in the specific field set forth in the qualifications. Therefore, the employee was ineligible for consideration. After trying unsuccessfully to get Personnel to reconsider, the manager felt forced to hire a person who had not managed in several years and had minimal experience using computers, a daily function of the position. This individual quit within four weeks. Shortly thereafter, the manager also lost the employee she had wanted to hire.

To get the hiring process to work, DOA bends the system - While the majority of supervisors are constrained by an ineffective system, we identified numerous examples of Personnel granting rule waivers or informal allowances to the process. For example, while most supervisors can consider only the seven candidates provided, we found many cases where Personnel had granted rule waivers allowing supervisors to review all candidates. We also found waivers allowing some supervisors to recruit at colleges or job fairs, which is typically unallowed. Other exceptions result from individual Personnel staff decisions to allow agencies more flexibility. For example, one hiring supervisor was

allowed to score candidate applications himself, even though current rules prohibit agency staff from scoring candidates. Additionally, Personnel has allowed some supervisors to use "substitute" qualifications, while others told us they were unable to update invalid qualifications.

Some agencies, dissatisfied with Personnel's ability to meet their hiring needs, solicited and received DOA's authorization to hire independently for certain positions. For example, the Department of Corrections has authority to recruit and staff its Correctional Service Officer positions, and the Attorney General's Office performs hiring functions for the majority of its covered positions.

Major Reforms Are Needed

A comprehensive reform effort is needed to change Arizona's hiring system and will require rule revisions and possible statutory changes. However, Personnel can take a number of immediate steps to improve the process.

DOA Personnel should redefine its role from enforcement to service - Consistent with personnel reform efforts across the country (see Introduction and Background), Personnel should reshape its organization to prioritize service to agencies and move away from viewing its mission as rule enforcement. For example, Personnel should provide State agencies with increased options in hiring services; options which include: 1) hiring responsibilities performed jointly by Personnel and the hiring supervisor, and 2) hiring primarily done by the agency, with Personnel functioning in an advisement and monitoring capacity.[1]

Additionally, agencies and Personnel should work jointly to communicate the importance of merit principles, and to develop systems to hold supervisors and managers accountable if they violate them.

Personnel is currently taking steps to improve service to agencies. Some agency representatives expressed that the new administration is open to change and moving in the right direction. Also, Personnel has a leadership role in the Human Resources Hiring Process Task Team. At the time of our audit, the task team was considering a number of changes to the hiring process and recommending a review of statutes and rules for possible amendment. Because the task team is still in the process of determining needed changes, it is unclear whether their final recommendations will address the major rule revisions and statutory changes that are key to achieving an effective hiring system.

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1. Even in its new role, Personnel can ensure merit principles are followed through an expanded audit function. As agencies take over functions now performed by Personnel, the State will need better mechanisms to audit and correct problems. Although audits are currently done on a limited basis, there are no positions dedicated and no formal audit schedules or procedures.

Statutory changes may be needed - At least two statutes appear to prevent the achievement of needed flexibility in the hiring system:

- First, A.R.S. §41-783.5 requires that candidates appear on hiring lists "*in order of relative excellence.*" This statute has been interpreted to require numerical scoring of all candidates. In some cases, however, numerical scoring and rank ordering may not be valid or efficient. The option of simply listing all candidates as "qualified" or "unqualified" should be available when it is more efficient.

- Second, A.R.S. §38-492 requires the awarding of preference points to veterans and handicapped candidates who take examinations for employment. These statutes may be adversely impacting State Affirmative Action goals and workforce diversity by causing many hiring lists to be dominated by veterans. Because veterans receive points over and above those of equally qualified nonveterans, the hiring list may contain only veterans when there is a high volume of qualified candidates for a position. While some public sector entities have eliminated veterans' preference points or restricted their usage, Arizona has not.

Major rule revision is needed - Some existing rules limit the State's options to respond creatively to its diverse hiring needs. Although many of these rules can be waived, a rule waiver requires the approval of the Personnel Director. Thus, agencies are forced to abide by a bureaucratic system which delays response to meeting their needs. Instead of continuing with a system that constrains both agencies and the Personnel Division, rules should be changed to allow flexibility to respond to diverse circumstances. Listed below are examples of rules that may be particularly problematic.

- Agencies are prohibited from administering any candidate evaluations other than the interview

- Applicants must be State residents

- Supervisors must use hiring lists comprised of internal promotional candidates prior to allowing outside recruiting

- Hiring lists are limited to seven candidates

- Hiring at above entrance salary is prohibited without raising the salaries of all current employees performing in the same job class.

Personnel should make immediate improvements - In the interim, while statutes and rules are being changed, Personnel can relax rules and policies to effect immediate improvement in hiring processes. Key suggestions for change are discussed below.

- **Allow Agencies Greater Freedom To Design Supplemental Applications** - In some cases, especially in technical positions, the standard State application does not elicit enough information specific to the skills needed for the job. According to the employment law expert we consulted, there is no legal problem caused by using supplemental applications designed by the agencies. Some agencies, such as the Department of Economic Security, are currently using supplements to obtain more information regarding the applicant's specific job skills.

- **Allow Supervisors to More Easily Update Inappropriate Job Qualifications** - Several personnel supervisors and staff told us that outdated qualifications are a fundamental problem in the system. Additionally, 10 of the 24 hiring supervisors we surveyed said the minimum qualifications (MQ's) for the position we inquired about were inappropriate. Inappropriate MQ's can, if too strict, screen out good candidates; or, if too lenient, cause unnecessary scoring and allow unqualified candidates to receive high scores. Currently, MQ's can be amended on a case-by-case basis by obtaining Personnel's permission to use a Substitute MQ. However, according to one supervisor, "*it takes an Act of Congress to get an MQ change.*" Additionally, the Substitute MQ does not accomplish a permanent change, but must be requested each time the position becomes available.

- **Allow Supervisors Maximum Participation In Candidate Evaluation** - The majority of hiring supervisors are not even contacted during the hiring process. Candidates not scored through written examination (over 80 percent of candidates) are evaluated by a Personnel Analyst, who reviews the application and awards scores based on how closely the application reflects the abilities and experience outlined in the rating plan. However, many hiring supervisors view the analysts as not having sufficient knowledge of the job to design the rating plan or determine whether the candidate's experience is applicable. In addition, the rating plans are not scrutinized for validity or reliability.

- **More Readily Correct Candidate Scores** - Personnel should make candidate score corrections when appropriate. If the results of investigations into a candidate's background, education, or work history bring out information that affects his or her rating, Rule R2-5-205.E.5. allows the rating to be adjusted. Many hiring supervisors provided us with examples of candidates on the hiring list who did not have the necessary qualifications, but appeared unaware that a correction mechanism exists. Others told us that it is difficult to get Personnel to make score changes.

- **Allow Access To Additional Candidate Names** - When hiring supervisors want to review the applications of additional candidates, Personnel should make these available. This can be accomplished by enabling supervisors to review all candidates meeting minimum qualifications (referred to as full-list certification), or to obtain a

supplemental hiring list. Personnel already uses rule waivers to make full-list certification available to many supervisors, and should consider issuing a policy describing the conditions in which it will be provided. In other cases, when supervisors have documented that candidates are unavailable or unacceptable, Personnel should release supplemental lists.

- **Timely Purging of Candidate Names From Registers** - Personnel should ensure that candidate registers are kept current. For some positions, rather than advertising externally, a hiring list is generated from an existing register of candidates. However, hiring supervisors complained that the lists are often outdated and contain candidates who are either no longer available, not interested in the job, or have been interviewed and disqualified for the position several times. Personnel is not using the extent of its ability provided by rules to remove names from the list, nor has it made clearing names a priority. According to one official, it may be months before names are cleared from the lists.

- **Allow Targeted Recruiting** - Targeted recruiting, which allows taking applications and interviewing candidates at colleges and job fairs, should be made available to all agencies. Personnel should consider waiving the rule on a Statewide basis, rather than approving requests on a case-by-case basis, as is done currently.

Low salaries will continue to affect quality of hires - Changes in the hiring system are of critical importance, yet the effect of State salary levels should not be underemphasized. While Arizona's hiring system should provide the mechanism to attract and hire the best of those people interested in State service, salary levels that are far below market may significantly reduce the pool of interested candidates. See Finding III for further discussion of compensation issues.

RECOMMENDATIONS

1. DOA Personnel should begin a comprehensive reform of the State hiring system, including:

   - Shifting Personnel's role from rule enforcement to service
   - Reviewing statutes and preparing recommendations for the Legislature
   - Redrafting the Personnel rules

2. In the meantime, Personnel should relax operating practices and rules to increase service to, and participation of, State agencies in the hiring process. Particularly, Personnel should allow:

   - The design of supplemental applications by agencies
   - An expedient method to update inappropriate job qualifications
   - Maximum supervisor participation in candidate evaluation
   - Correction of candidate scores
   - Access to additional candidate names
   - Prompt purging of names from registers
   - Targeted recruiting at colleges or job fairs.

FINDING II

DOA NEEDS TO ADDRESS FUNDAMENTAL PROBLEMS WITH THE STATE'S CLASSIFICATION SYSTEM

Fundamental issues need to be addressed in the State's classification system before anticipated changes are made. While a classification system is an essential element of an effective and efficient organization, the State's system is not properly maintained or managed. This neglect impacts hiring and compensation, vital components of the personnel system. Currently, DOA is considering significant changes to the classification system. However, efforts to modify the existing system may be premature, particularly until funding issues are addressed, and an assessment of needed changes is developed.

Classification System Is A Crucial Element

Classification systems provide large organizations, such as the State, with a structured process to define and determine compensation for a sizeable number of positions. The classification system is so basic and essential to an organization's functions it can be called its "backbone." Through evaluating positions and grouping similar jobs, the classification system provides for equitable compensation and establishes a hierarchy of positions. For each position, the classification system should provide:

- A clear and accurate description of the job and its duties and responsibilities;
- The level of compensation for the position; and
- A description of the skills, experience, education, and training needed for the job.

The State's classification plan, required by statute, uses the whole job method to evaluate jobs. In this method, each position is evaluated based on factors such as: difficulty of duties, qualification requirements, nature and scope of decisions, and type of supervision.

Poor System Maintenance Due To Lack Of Funding And Review Schedule

Although crucial to the State government's effective operation, the classification system is not adequately maintained. DOA officials indicate that lack of funding has hampered efforts to maintain it.

System is not maintained - Despite its overall importance, DOA is not ensuring that the State's classification system remains current. To do so requires the Personnel Division to conduct periodic reviews of each classification to determine the actual work conducted, appropriate levels of compensation, and a comparison of position rankings. While a prior Auditor General review of the Personnel Division (see Report 81-9) found the classification system had not been maintained since its adoption in 1969, our current analysis indicates a continued lack of maintenance over the last several years. Specifically, from 1988 through 1992, only 22 percent of all State government classifications (representing 38 percent of all positions) have been reviewed by Personnel. Further, some classes have not been reviewed for over two decades. For example, according to a Personnel Division official, Right of Way Agent classes at the Arizona Department of Transportation have not been reviewed since 1968. In fact, the system is so neglected that DOA could not confirm for us the reviews done in the past ten years, until a list was constructed specifically at our request.

Lack of funding impacts efforts to maintain system - According to DOA officials, a lack of funding to implement salary adjustments resulting from classification reviews hampers the Personnel Division's efforts to maintain the system. These officials indicated that after the Legislature chose not to fund the salary adjustments associated with several reviews completed by the Personnel Division in 1989, DOA elected to discontinue any regular program of classification reviews. Instead, reviews are limited to those agencies able to assure funding for any recommended upgrades, or those that can show they are experiencing operating problems stemming from outdated classifications.

Neglect Affects Several Vital Components Of Personnel System

Fundamental elements of the personnel system cannot function properly when the classification system is not kept current. Because of outdated job descriptions, agencies are often unable to recruit candidates with the skills to meet the agencies' needs. Further, failure to perform classification reviews results in compensating employees inappropriately.

Hiring impacted by outdated specifications - Hiring, crucial to an effective State government, is hampered when position specifications are not kept up-to-date.

Maintaining current position specifications, including minimum qualifications (or the minimum education, experience, and skill requirements considered necessary for a position) are a basic function of the classification process. As such, when classifications are not kept current, applicants are screened using minimum qualifications that no longer reflect the job functions. For example:

- PUBLIC ASSISTANCE ELIGIBILITY INTERVIEWERS
  Employees in this position authorize significant State expenditures of welfare monies and other entitlement programs. Qualities needed in these positions include: decision-making skills, investigative skills, ability to interpret laws, and the ability to do math calculations. However, according to DES officials, applicants passing minimum qualifications are those with only receptionist and public contact experience, such as working at fast-food restaurants.

- TRANSPORTATION ENGINEERS
  These classifications have not been reviewed in over a decade and include minimum qualifications requiring construction experience, which, according to ADOT officials, "*severely limits our ability to hire*" because "*we do not need construction*" experience in this particular position.

- PLANNERS
  According to agency management, the best candidates are eliminated from consideration. Applicants with research and environmental planning skills are screened out by the requirement for supervisory experience, which management feels is unnecessary for this position. This class has not been reviewed since 1976.

Lack of classification reviews affects compensation - When classification reviews are not performed on a regular basis, the State's system of compensating employees is affected in several areas. Pay grades are established from determination of what is appropriate compensation for job duties, responsibilities, and qualifications. As such, when classification reviews are not current, inequities may occur between what is appropriate pay for functions performed in a position and pay actually received. Inequities may also result between positions when employees perform jobs similar in responsibilities and duties, but receive different compensation.

Proposed Changes Premature Until Funding Is Addressed And Needs Are Assessed

DOA is currently evaluating substantial changes to the State's classification system. However, these changes may not be needed to ensure an effective classification system. Before attempting to modify the system, DOA should assess what changes will be most effective. DOA should also address the historical problems of obtaining funding for the system. Finally, DOA should evaluate a new classification strategy with important implications for reforming the personnel system.

Proposed changes to have significant impacts - Based on the 1992 SLIM report on the Personnel Division, an outside consultant is reviewing the job evaluation methodology utilized in the current classification system. The consultant is anticipated to recommend that DOA adopt a new and significantly different job evaluation methodology that ranks positions based on an assignment of points to the various functions performed in each job. However, if DOA accepts this recommendation, a considerable initial investment, preliminarily estimated at $68 million for the first year, will be needed. This estimate includes expenditures for:

- New computer software and hardware;
- Training for classification analysts; and
- Initial salary adjustments associated with the review.

In addition, agency operations will be impacted by the need for managers and employees to participate in detailed analysis of descriptions and job duties of all current positions, while morale and productivity may suffer if employees become concerned about positions being affected or eliminated.

Changes may not be necessary - Making significant and costly changes to the classification system may not be needed to ensure its effectiveness. Preliminary reports from DOA's consultant indicate that a new job evaluation methodology is needed to reduce the number of classifications and eliminate the "subjectiveness" of the current methodology. However, personnel experts we have spoken with indicate that the number of classifications could be reduced using the current methodology, and that the point factor methodology the consultant is anticipated to recommend is susceptible to similar criticisms of subjectiveness. These factors suggest that, before embarking on a major effort to change the job evaluation methodology of the current classification system, DOA should first determine what it hopes to achieve from any changes, and then seek the necessary legislative support. Specifically, DOA needs to determine those changes that will best assist State agencies in accomplishing their missions. Modern classification systems recognize organizational needs and are designed to incorporate such factors as:

- Responsiveness to organizational change
- Career development
- Employee performance and accountability
- Flexible compensation programs
- Delegation of classification responsibilities

However, our audit work indicates that DOA has made only a limited effort to obtain input from stakeholder groups. While DOA's consultant conducted interviews of agency administrators, employees and legislators who also have an interest in the creation of an effective classification system were not contacted.

To ensure the classification system's effectiveness, DOA must also address the historical absence of funding needed to maintain it. As discussed earlier, DOA has basically halted any efforts to maintain the current classification system, based on the perception that the Legislature will not fund the salary adjustments associated with reviews. Any future systems will also become outdated if they are not maintained. Before DOA can embark on any effort to revamp and upgrade the classification system, legislative involvement and support will be an important step.

Framework for modern classification system should be evaluated - When assessing the most appropriate changes to the existing system, DOA should also evaluate a new model for classification systems that has important implications for reforming the overall personnel system. This model, developed by the National Academy of Public Administration (NAPA) for the Federal government, classifies work, rather than positions, because "*classifying work places an organization in the best posture to develop, promote and use the skills of its work force.*" By grouping similar classes together, and establishing levels that allow for logical career paths within each class, the NAPA model supports a flatter organization, values generalists and the knowledge and skills of workers, allows greater job mobility, and encourages employee development.

Several public and private entities are implementing or studying NAPA's broadbanding model, including the States of Minnesota and Washington, nationally recognized for their efforts to reform their personnel systems. Both states are using the broadbanding model not only to flatten their organizations, but to create an atmosphere that will be conducive to changing their personnel systems.

RECOMMENDATIONS

DOA should develop a plan to establish the future purpose and direction of the State's classification system. This plan should include:

- What State government hopes to achieve from its classification system,
- The strategies to reach these goals, including the most appropriate framework and method of job evaluation, and
- An approach to obtain legislative support for the need to maintain and enhance the classification system.

FINDING III

DOA SHOULD IMPROVE EFFORTS TO INFORM DECISION MAKERS ON SALARY ISSUES

Although State employees are an essential resource of State government, employee salaries have not remained competitive. While salaries were only 7 percent behind the market in 1988, lack of salary increases has now increased the gap to over 22 percent. As a result, State agencies have difficulty attracting and retaining high-quality employees. To date, DOA's efforts to impact compensation decisions have been curtailed due to the timing of its recommendations, as well as DOA's tendency to base its recommendations on available funding after all other budgetary priorities have been addressed. For DOA to have a meaningful impact on compensation decisions, it needs to provide the Governor and Legislature with timely, objective, and comprehensive reports detailing various alternatives.

State Employee Salaries Lag Behind The Market And Inflation

Lack of salary increases have caused State employee compensation to fall significantly behind the market. Further, when coupled with inflation, lack of salary increases have served to decrease employees' purchasing power.

Salaries lag behind market - According to the Joint Governmental Salary Survey conducted by the Personnel Division, the average State employee salary is 22.5 percent behind the average market salary as of July 1, 1992.[1] For some positions the gap is even greater -- electricians and physical therapists are 29 percent behind market. The market lag grew quickly during a four-year period in which there were few or no increases in State employee salaries, while there were approximately 3 to 5 percent annual increases in the market salaries.

Real income has decreased - The lack of salary increases in recent years is having a major impact on employees' purchasing power. Due to the effects of inflation, real income has decreased for State employees. Over the last five years, inflation has risen almost 16 percent, while State employee salaries rose only 3.1 percent. The cumulative

1. The methodology utilized in the Joint Governmental Salary Survey, and its conclusions, were recently validated in consultant's analysis for the Governor's Office of Excellence in Government.

effect of this gap is that real income for the average State employee decreased by $2,436 from fiscal year 1988-89 to fiscal year 1992-93[1].

Although commonly held that the level of benefits State employees receive compensate for the difference in salary, this is not the case. Recently, Coopers and Lybrand performed an analysis of the Joint Governmental Salary Survey and found that benefits do not bridge the 22.5 percent pay gap. The study noted that an employee whose salary alone is 20 percent behind the market is still 17.8 percent lower than market when benefits are included.

Low Salaries Impact Recruitment And Retention

Low salaries have impacted the State's efforts to recruit and retain qualified employees; however, efforts to address salary issues have been fragmented.

Low salaries hamper recruitment and retention - Low State salaries have hampered recruitment efforts for many positions. A review of current literature on compensation shows that employers who consistently pay salaries lower than the market rate will have a difficult time attracting a sufficient number of qualified people. In fact, when asked what factors prevented the hiring of qualified people, hiring supervisors we surveyed cited low salaries more than any other factor. Further, our panel of agency Personnel representatives listed low salaries as a significant problem hampering their efforts to attract and employ quality individuals.

The lack of competitive State salaries also contributes to problems in retaining employees. According to current compensation literature, when pay is below market, an employer will not be able to retain people no matter what other retention efforts are made, and turnover will tend to increase. The hiring supervisors on our panel indicated that this holds true for the State in that the low salaries are causing problems with employee retention. In fact, two State agencies which conduct exit interviews found that over 50 percent of the respondents left State service due to low salary. Turnover is quite costly for the State -- current literature suggests that turnover costs can run as high as $5,000 per position filled. This figure includes not only the cost of recruitment efforts to refill the vacant positions, but also the cost to train new employees, and the productivity lost due to the vacancies.

Fragmented approach used to address problems - In recent years, a piecemeal effort has been made to increase State employee salaries, resulting in fragmentation of the compensation system. State agencies have pursued a number of avenues in an effort

1. The impact of inflation on the average State employee's income was calculated using the average metro Phoenix Consumer Price Index (CPI) for each fiscal year from 1988-89 to 1992-93 (provided by the center for Business Research, Arizona State University).

to obtain salary increases for their employees. Typical methods used to increase pay for particular individuals or positions include:

- SPECIAL APPROPRIATIONS - Agencies have lobbied the Legislature for additional salary monies. Some agencies, such as the Department of Corrections and the Department of Public Safety, have been successful in obtaining additional monies for salary increases.

- SPECIAL RECRUITMENT RATES - Some agencies facing recruitment problems are granted permission by DOA to offer a starting salary above the minimum in the salary range.[1] Use of special recruitment rates is not uncommon ,and they are used for 144 classes in the State service, or just over 9 percent of all classes. However, this practice causes salary compression by bringing newer employees in at rates near or above existing employees.

- RECLASSIFICATIONS - Based on special requests prepared by agencies, DOA will review specific positions to determine whether the position should be reclassified to a higher grade level. During 1992, agencies received DOA approval to reclassify over 1,600 positions (or 5 percent of all State employees).

- VOLUNTARY GRADE DECREASES - Agencies are able to obtain pay increases for some employees by manipulating two Personnel rules. First, the employee takes a voluntary grade decrease and in most cases, retains his/her former salary per Personnel rules. Then, the employee is promoted back to his/her original grade and receives the mandatory 5 percent increase in pay required by the Personnel rules. Because these actions are not tracked, we were unable to determine the frequency of such occurrences; however, DOA officials indicated that this practice is not uncommon.

While State agencies may be successful in increasing salaries for particular individuals or classes, the overall salary problems continue. Further, such approaches to salary increases cause inequities between similar positions in other departments and agencies.

DOA Should Provide Decision Makers With Information And Options

While DOA has been charged with providing salary recommendations, its recommendations are of limited value. DOA's recommendations are based on available funding rather than the results of its analysis. For DOA to have a meaningful impact

1. Personnel rules mandate that new hires must be compensated at the entrance rate for the pay grade for the position, unless a special recruitment rate is authorized by Personnel.

on compensation decisions, it needs to provide the Governor and Legislature with timely, objective, and comprehensive reports detailing various alternatives.

DOA should provide independent recommendation - Currently, the DOA Director is required by statute to "*make an annual recommendation to Legislature and the Joint Legislative Budget Committee of a salary plan and adjustments to the plan for employees in the State service ... on or before January 1 of each year.*"

In reality, the DOA Director's annual recommendation is guided by the executive budget proposal, rather than the salary plan adjustments needed to maintain an adequate compensation system. The DOA Director stated that the annual recommendation is a political document and as an appointee of the Governor, his recommendation should be consistent with the Governor's budget. Therefore, recent annual recommendations have been made based on the budget monies available. The link to the budget is so great that DOA even sought to have their reporting date changed from December 1 to the current January 1, in order to coincide with the release of the Governor's budget.

For a meaningful recommendation to be made, DOA needs to change both the nature and timing of its recommendation. As the State's compensation professionals, DOA should be providing decision makers with complete and objective information on the compensation of State employees. If DOA does not provide this information, there is no one else who will do so. Further, the compensation information should be provided before budget documents are compiled and decisions regarding budget priorities are made. This would allow both the Governor and the Legislature to consider all the needed information, and then allow the political process to determine whether salary issues will become a budget priority.

DOA should provide more comprehensive information - While DOA provides the Legislature with salary information in its annual recommendation, it is limited to the results of its annual salary survey. The report includes only the percentage by which State salaries lag behind the market in six broad categories.

Other states provide much more comprehensive information in their compensation reports. These reports include analysis on average pay levels, market comparisons, and other useful information. Some examples of the types of information other states compile include:

- Specific compensation information, such as employee distribution by grade, average annual salary, amount of sick and annual leave accumulated, cost of leave taken per employee, and the cost of overtime

- Comparisons with other states, such as rank in average state salary and rank in state employees per population

- Trends, such as average salary differences over the last five years and the cost of leave taken over last ten years

DOA should present alternatives - To further improve the annual salary recommendation, DOA should present alternative solutions based on analysis of the salary plan. For the recommendation to be effective, each alternative should be presented clearly, with a discussion of the compensation problem it is intended to solve, how this alternative will work to solve it, and what the effects will be. For example, DOA could present alternatives for across-the-board salary increases, increases that target groups experiencing high turnover, or increases that target groups whose salaries are farthest from the market. In addition, it could provide varying funding choices such as a specific percentage salary adjustment, a fixed-dollar general salary adjustment, or a particular percentage merit increase, and discuss the effects of each. At a minimum, DOA should provide the following information for each alternative:

- Description of the alternative,
- Advantages and disadvantages,
- Suggested priority order for actions to be taken,
- Suggested implementation strategy,
- Cost impact,
- Employees affected, and
- Other analysis or information useful to decision makers.

RECOMMENDATIONS

1. The Legislature should consider amending A.R.S. §41-763.5 to require that the annual salary recommendation be made to the Governor and the Legislature by early fall of each year, and that the recommendation include alternative approaches to compensation issues, in order to address the State's compensation problems.

2. DOA should prepare recommended salary adjustments based on the results of its analysis and allow policymakers to determine whether the salary issues will become budget priorities.

FINDING IV

DOA NEEDS TO MORE PROACTIVELY MANAGE ITS EMPLOYEE HEALTH CARE BENEFITS PROGRAM

The Department of Administration's Personnel Division needs to more proactively manage State employee health insurance benefits. In early 1992, in an effort to prevent significant premium increases to the State, the Division made several controversial decisions. These decisions, however, increased costs and/or reduced services to both State employees and retirees. To prevent similar problems from occurring in the future, the Personnel Division needs to ensure that State employees' health care needs are defined in conjunction with the Legislature and State employees, that usage is monitored, and that its Request for Proposals is specific. Further, whenever a new contract award is made, DOA needs to ensure that employees are adequately notified, and that carrier performance is monitored.

Decisions Made To Contain Costs Result In Controversy

In an effort to thwart an increase in health care costs, DOA made several controversial decisions. These decisions resulted in reduced services and increased out-of-pocket costs for a number of State employees and retirees. Due to considerable pressure from many sources, the Division has made some changes to specifically address these problems; however, their cause has not been addressed.

Decisions made to avoid cost increases - In 1992, the Personnel Division received a proposed premium increase of over 26 percent from its health insurance carriers. The Division projected that the premium increases would cost the State an additional $44 million per year. However, the Governor mandated that there be no increase in State funding for employee health insurance. After weeks of negotiations with the insurance carriers, the Division determined that they had reached an impasse.

In an effort to prevent an increase in State health insurance premiums, the Division made several controversial decisions. First, the Division decided to place the health insurance contracts out to bid, rather than continue the current contracts, although there was very little time to complete the bidding process. In addition, the Division changed the way bids were requested to separate the more expensive groups, retirees and rural employees, from the general risk pool (to discontinue subsidizing of these groups by urban State employees). The Division also allowed the carriers to define the coverage they would provide, rather than the Division explicitly indicating the State's needs. Finally, the Division selected a cost-sharing strategy whereby the State

contributes an equal amount toward premium costs for each employee located in a given geographic region, rather than contributing more toward the more expensive plans. While these decisions did result in savings to the State, employees and retirees suffered the following consequences:

- Because the counties were bid individually, insurance plans offered different coverage for rural and urban employees. While HMO coverage had been previously available in most counties, in many rural counties HMO coverage was either eliminated or altered such that it was no longer a viable option. Many State employees in rural communities found that while HMO coverage was available, their community either lacked providers and/or a participating hospital. Further, urban employees were no longer offered an indemnity plan.

- Retirees, rural employees, and those urban employees enrolled in non-HMO plans were faced with huge out-of-pocket increases. Some retirees saw premium increases of over 50 percent (from $485 to $757 per month for family coverage). Further, some rural State employees were offered only indemnity coverage and were faced with paying up to $1,250 per person or $2,500 per family in out-of-pocket expenditures.

- Some employee populations were left without coverage for their medical conditions, although they had coverage under past plans. For example, a prior plan had covered durable medical equipment and diabetic supplies, and the new plan limited coverage for some of these items. In other instances, medical conditions were covered, but at a much greater cost. For example, hospice and home care which had previously been available through the indemnity program at 80/20 and no limits was limited to 70/30 coverage, with a $7,500 maximum.

- Employees in rural areas of the State reported that they were unable to find providers. In some instances, the employees found that providers listed in the directory were not accepting new patients.

- Because new carriers were added and these new carriers had a short lead time to begin providing service, employees received inadequate service from the carriers at the beginning of the plan year. Claim payments were delayed for over two months by one carrier, and some employees did not receive plan information or identification cards from two carriers for several months.

Division took action to reduce burden on employees - After receiving pressure from employee groups, legislators, the media, and an employee petition drive, the Division made some changes to the medical plans to address employees' concerns over coverage and cost. The Division added coverage for conditions that had been omitted under the new plans and decreased deductibles and out-of-pocket costs for employees living in the rural areas. The Division also encouraged the development of HMOs in some of the rural areas to provide plans with lower employee costs. Although these

actions reduced some of the employees' financial burdens, they do not address the problems' causes.

Number Of Actions Needed To Avert Future Problems

DOA needs to take a number of steps to prevent similar problems from occurring in the future. DOA needs to work with legislators and employees to define the State's health care needs and goals. Further, DOA needs to monitor health care utilization to prevent "surprise" increases. Finally, when DOA does go to bid, it needs to ensure that its Request for Proposal (RFP) is as specific as possible.

Division must define the health care program with input from concerned parties - Because key policy questions regarding the State's health care program remain controversial, decisions need to be made regarding what coverages should be provided. For example:

- What types of health care plans should be offered (i.e. HMOs, Indemnity, PPOs)?
- Should coverages and costs vary between urban and rural employees?
- Who should be covered (i.e. retirees and current employees)?
- What level of coverage should be provided?
- How should costs be allocated between the State and its employees (i.e. equal contribution for each employee versus greater subsidizing of the more expensive plans)?
- Should the current contracts be renewed or rebid?

In defining State health care program needs and goals, DOA needs to work in conjunction with the Legislature. In procuring the health insurance programs in 1992, the Division excluded legislators from its decision making process. Not only did the exclusion result in less-than-desirable coverage for employees and retirees, it eliminated the Legislature's ability to take action to avert the problem. For example, during a legislative meeting, a legislator indicated that had the Legislature been aware of the increasing cost of the former health care plans, it may have elected to continue those plans by funding the premium increase, instead of offering an employee raise.

Further, legislators noted that the decision to separate retirees from the rating pool drastically impacted their policy to offer early retirement packages to employees.[1]

Further, because decisions so strongly impact employees, efforts should be made to ensure that employee interests are considered and to identify potential problems. Other states, as well as other Arizona employers we contacted, indicated that they use employee focus groups, surveys, and committees when planning benefits programs.

Division does not monitor claims experiences - As described previously, the Division was surprised by the large increases proposed for renewing their contracts in 1992 and this was due, in part, to a lack of utilization data. Utilization data is critical in allowing the Division to know how much carriers are expending for claims, and whether premium increases may be warranted during contract negotiations. Although the State's provider contracts require monthly, quarterly, and annual utilization reports, the Division has not ensured that all carriers have submitted these reports on a consistent basis. In addition, when information is received, it is often untimely, incomplete, and unreliable.

Our panel of benefits managers indicated that employers must push the carriers into providing data on how health care dollars are being spent. Without obtaining this information, the Division cannot monitor and evaluate the services carriers are providing or determine what medical services the State is paying for.

RFP needs to be specific - Contrary to its 1989 RFP, DOA's 1992 RFP was vague with regard to the State's desired health coverage. According to DOA officials, the RFP was intentionally left open so that the Department could identify the most cost-efficient carriers in each area of the State. However, by not dictating what coverages it desired, the State was left to choose from the various plans offered and varying benefit levels. Thus, when the contracts were awarded, employees in various geographic regions had varying plans and different benefit levels.

In the future, DOA should prepare a detailed request for bids specifying the coverage desired for State employees. The RFP should detail the plan design and specify deductibles and co-insurance levels. If the Division needs to explore alternative plans, this can still be done in the RFP. The State of Kansas, for example, included several questions for the carriers about options they were considering, after they had presented the specific plan design. The RFP also allowed carriers to bid an alternate plan in addition to those that were specified.

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1. After being excluded in 1992 decisions, the Legislature enacted legislation in 1993 establishing the Legislative Oversight Health Insurance Benefits Review Committee. The Committee has been charged with reviewing some of the more controversial problems stemming from DOA's 1992 decisions, including whether retirees should be regrouped with State employees, whether there are ways to minimize the differences in coverages between rural and urban employees, and whether employees who terminated coverage in the last six months of 1992 should be allowed to reenroll.

Additional Actions Needed Once An Award Is Made

When DOA awards new contracts, it needs to ensure that employees have sufficient information regarding coverage options on which to base their selection decisions. Further, DOA needs to monitor carriers to ensure they are meeting contract requirements.

Communication regarding coverage options is important - During the open enrollment period in 1992 in which the new benefit plans were introduced, employees received incomplete information regarding them. Although the State was adding new carriers and eliminating coverages with others, employees could not determine from materials provided what medical conditions would be covered. For example, employees enrolled in one plan were not informed for several months that allergy shots were not covered on an out-of-network basis. Further, although the State held meetings for employees to learn about the new plans, carrier representatives were not present and the Division representatives providing the information lacked specifics.

Other states use a variety of methods to distribute benefit information. For example, Nevada produces a video presentation of the benefits plans to use at open enrollment meetings and for new employee orientation. Ohio and Utah arrange a health benefits fair at open enrollment where carrier representatives are on hand to answer questions for employees.

Once employees select health plan options, DOA needs to ensure that they promptly receive information regarding how and where to obtain medical services. In 1992, employees enrolled in some programs did not receive users manuals until two months after the date coverage began. Complaints were received that employees were confused about where to go for treatment. This was especially problematic for those enrollees who experienced medical emergencies.

Division needs to monitor carrier performance - The Division should monitor the carrier's performance to ensure employees are receiving adequate service. The Division has set several performance standards for the carriers in the contract. For example, carriers are required to pay 90 percent of claims within 14 calendar days of receipt, achieve a payment processing accuracy rate of 95 percent, and have a 75 percent satisfaction rate. The contract also allows monetary penalties for failure to meet these standards on a quarterly basis.

Although empowered by the contract to monitor performance, the Division has failed to do so adequately. Without this monitoring, the State does not know if the carriers are meeting the contract terms. Further, the State may not be collecting the penalties to which it is likely entitled. For example, one carrier delayed some claims payments well beyond the 14-day standard for the first quarter of the plan year, however the Division did not determine the extent of the delays, and thus does not know if the State is entitled to a 5 percent reduction in the carrier's retention fees for the quarter.

RECOMMENDATIONS

1. In making major policy decisions, the Division should include employees and the Legislature in the decision making process to help define goals for the health insurance plans.

2. The Division should establish the design of the health insurance plans prior to beginning the procurement process, and include the specifics of the plan design in the RFP.

3. The Division should improve communications with employees on the benefits programs.

4. The Division must work to obtain utilization information from the carriers and use this information to project potential carrier premium increases and determine their validity.

5. The Division must monitor the health insurance program and evaluate the insurance carriers for achievement of performance standards, assessing the contractual penalties for nonperformance.

FINDING V

THE DIVISION SHOULD IMPLEMENT MECHANISMS TO CURB ESCALATING HEALTH CARE BENEFIT COSTS

Soaring health insurance costs have forced governments and private companies across the nation to seek control over further increases. Arizona's cost to provide its employees' health benefits has risen to $168 million, with additional increases on the horizon. While the Personnel Division has taken some steps to curb costs, it should consider implementing additional cost containment measures utilized in other states and private industry. In addition, it should monitor health care expenditures to target costly areas.

Health Benefit Costs Rapidly Rising At The National And State Levels

Nationally, the cost of health care is increasing at a rapid rate. Currently, the medical inflation rate is outpacing the Consumer Price Index and insurers are predicting that the cost for the typical medical plan will increase 20 to 25 percent per year. In fact, studies predict that by the year 2000, employers will need to spend over $20,000 per employee each year to provide traditional health insurance plans[1]. Benefits literature attributes the increasing costs to medical inflation, technological changes, and use of costly medical treatments.

In line with national trends, Arizona has also experienced dramatic increases in its health insurance costs, with future increases predicted. Between fiscal year 1989-90 and 1991-92, the State's contribution toward employee benefits rose almost 35 percent (from $101 million to $135 million). Over this same period, the average premium cost paid by Arizona per employee rose from approximately $2,400 to $3,000 (25 percent increase). For fiscal year 1993-94, the program will experience a cost increase of 5.9 percent overall, with one plan increasing by over 15 percent. One Arizona carrier projects health care cost increases to be about 14 percent per year. Even if cost increases were kept to 10 percent annually, the State would be expending over $200 million within 5 years.

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1. Higgins, A.F., "Yes, Companies Can Cut Health Costs," Fortune Magazine, July 1, 1991, p. 52. Rimler, G.W., "Managed Care: the Solution or the Problem?," Benefits Review, May-June 1992, p. 39.

The Division Should Consider Aggressive Cost Containment Measures

Although increases in health care insurance are likely to continue, the Personnel Division should consider implementing measures taken by other states and private companies to lessen the extent of the increases. The Division has made some efforts to curb its costs, yet additional efforts should be considered. "Carve out" programs could be instituted to reduce the cost of mental health and drug programs. In addition, implementing a wellness program and conducting eligibility audits could lessen utilization of health insurance.

A variety of sources were utilized to identify commonly used cost containment measures. We conducted an extensive literature search of over 100 current benefits articles. In addition, we surveyed seven other states regarding their programs.[1] Further, we interviewed human resources and benefits professionals representing several major Arizona employers and held a panel discussion with a group of these professionals.[2]

From this research, we discovered a variety of cost containment measures currently in place within other organizations. While the Personnel Division is already utilizing some measures, such as the use of less costly managed health care plans (i.e. HMOs versus indemnity plans), we identified other measures which DOA should consider implementing to curb cost increases. These measures are presented as follows.

"Carve out" of mental health and prescription drug programs - Under Arizona's current health benefit plans, all health care services are provided by the plan providers. However, a number of Arizona employers and other State officials we interviewed indicated that they have revised their plans to essentially "carve out" some of their more costly services, including mental health and prescription drug programs. These programs are then separately contracted and managed.

Managed mental health/substance abuse programs could be an effective mechanism to manage both costs and the care provided. Two of the larger Arizona employers we interviewed indicated that they had implemented this type of program and had positive feedback from employees; both felt that employees were receiving better care than had been previously provided. Several other states, including New York and Ohio, had also implemented managed mental health/substance abuse programs.

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1. We selected the states in our survey based on geographic location (Utah, Nevada, and Colorado), a similar covered employee population to Arizona (Ohio and Kansas), and recognition in the literature for having successful cost containment programs (New York and Illinois).

2. Our panel consisted of human resource and benefits professionals from Salt River Project, Arizona Public Service, McDonnell Douglas, Honeywell, and the City of Phoenix.

Managed prescription drug programs are another means of providing better cost control. Prescription drugs generally account for about 15 percent of an employer's expenditure for health care, and the cost of drugs is rising at over 20 percent annually. Some employers separately manage prescription drug programs and encourage the use of less costly prescription drugs through techniques such as generic substitution, differing copayments for brand name and generic drugs, use of a mail-order service, and use of a formulary (a predetermined set of cost-effective drugs).

Comprehensive wellness program - Studies indicate that wellness programs can be an effective means of reducing utilization of medical plans through developing a healthier workforce. Wellness programs typically include employee health screenings to determine areas of health risk, educational programs aimed at educating employees in health risk areas identified in health screenings, and follow-up screenings and counseling to measure progress toward wellness goals. Further, some wellness programs provide incentives to employees to encourage them to participate.

Although it is difficult to measure the dollars saved by wellness programs, there are some compelling reasons for implementing them. Lifestyle-related illnesses are costly; in fact, lifestyle-related costs are estimated to account for 55 percent of all health care costs. One study indicated that employees who smoke or drink excessively, or who are overweight, cost employers up to $900 per employee in excess costs per year. Employers with comprehensive programs have experienced lower health care costs and reaped additional savings from reduced absenteeism and turnover.

The Legislature, recognizing the value of wellness programs, passed legislation in 1990 requiring DOA to implement such a program. Further, funding for wellness programs is available through the Special Employee Health Insurance Trust Fund.[1] In spite of the legislation and funding, the Personnel Division has developed a very limited program consisting of a library of material for employees to use, distribution of a wellness/benefits newsletter, and offering of wellness classes. In fact, for fiscal year 1992-93 the Division budgeted over $380,000 for wellness programs; however, as of May 31, 1993, they have spent less than $34,000 for wellness activities.

Implementation of measures to eliminate ineligible dependents - Another means of decreasing utilization of health insurance is by eliminating coverage for ineligible dependents. Although enrolling ineligible dependents on insurance plans is a common form of employee fraud, the Personnel Division does not have adequate mechanisms in place to prevent or detect such occurrences. Prior to enrolling dependents, the Division should require proof of eligibility. Currently, the Division limits its screening efforts to a review of the enrollment application for inconsistencies (such as children with last names different from the employee's). Some other employers require

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1. The Special Employee Health Insurance Trust Fund was established by A.R.S. §38-654 for use in administering the State employee health insurance monies. These monies are collected from employer and employee premium contributions and can be expended for health insurance premiums, claims costs, administration, and plan improvements. As of May 31, 1993, the Fund had a balance of over $1 million available for wellness programs.

employees enrolling dependents to provide supporting documentation, such as a marriage license or a birth certificate.

In addition, the Division should consider conducting eligibility audits to identify ineligible dependents who are already enrolled. The City of Chicago, for example, conducted a year-long investigation which resulted in letters being sent to 1,988 employees questioning the eligibility of their 3,228 dependents (the City had 130,000 employees, dependents, and retirees). The investigative report showed that there was gross abuse of the City's health care benefits, including the carrying of ex-employees who were no longer paying, and employees enrolling ineligible grandchildren and college-age children.

Finally, the Division should develop a policy which includes penalties to deter employees from enrolling ineligible dependents. Currently, Arizona has no such penalty. The Division should establish a policy on handling employees who commit enrollment fraud, and communicate it so that it is well known. Two of our panel members indicated that it is their companies' policy that enrollment fraud is grounds for termination. In addition, one of our panel members indicated that during open enrollment, employees are given an "amnesty period" whereby they are provided with clear notice as to which dependents are eligible, and then given the opportunity to drop those who are not.

Personnel Division Needs To Monitor Costs To Effectively Target Its Cost Containment Efforts

For the Division to implement effective cost containment measures, it needs to obtain comprehensive and accurate expenditure data from the carriers. Expenditure information is critical for determining actions needed as well as monitoring the impact of actions taken.

Necessary information lacking - While the Personnel Division receives expenditure reports from its three carriers, the data does not allow the Division to adequately analyze cost containment options. We reviewed the expenditure report submitted by one of the carriers for the period of August 1 through October 31, 1992, and found that the carrier listed a majority of claims paid as "unknown," and thus did not indicate the types of services rendered. Without this information, the Division is limited in its ability to determine what cost containment actions are warranted.

Part of the Division's problem in obtaining reliable data may stem from its failure to require such information. The Division's contracts clearly indicate that it is entitled to expenditure information from the carriers. While it has received information, it has, to our knowledge, not attempted to force the carriers to submit complete and reliable information. Further, we saw no evidence that the Division attempts to use the information to routinely perform any analyses of its expenditures.

Cost containment efforts should be targeted and measured - Lack of comprehensive expenditure information limits the Division's ability to identify needed cost containment measures. Expenditure information is critical to determining areas with high expenditures, or problematic areas needing attention. This information should be used in designing the State's wellness program and in modifying the design of the health care plan. Other employers have used cost information to target their efforts to control costs; for example:

- One of our panel members commented that in reviewing trends in his company's utilization data, he found that prescription drug expenditures were high, which then triggered a decision to address this area through a carve-out from their existing plans.

- Another panel participant noted that reviewing the top ten expenses for his company's health insurance program impacts what is offered through the company's wellness program. For example, if premature babies are a top expense, then prenatal care may be added to the wellness program.

- A university in New York established a committee to identify potential cost containment areas. The committee analyzed the employee population's health care cost demographics and trends, and conducted a specific utilization analysis of the health plans. As a result of its analysis, numerous changes were made. For example, the indemnity plan was revised to make it easier and less expensive for patients to seek mental health care on an outpatient basis. Further, the university offered an incentive program (cash payments of $300 to $500 per year) to encourage employees to use their spouses' health benefits rather than the university's plans. In addition, the wellness program was revised to offer programs designed to address problems found during their health screenings.

Comprehensive expenditure information is also necessary to evaluate the effectiveness of cost containment measures that are taken and to identify areas where further efforts are needed. The Division needs to have information available on the utilization expenditures of the health plans both before and after implementing cost containment measures to allow evaluation of their impact. For example, a New York university evaluation committee began with techniques that it later realized had limited value, such as adjusting premiums to shift more costs to employees. By studying the impact of its changes, the committee was able to evaluate its actions, and then make additional changes to modify its efforts.

RECOMMENDATIONS

1. The Division should consider implementing cost containment techniques used by other employers, including carving out of the mental health or prescription drug programs, developing a comprehensive wellness program, and conducting eligibility audits.

2. The Division should obtain adequate expenditure data on the health plans in order to target and measure the effectiveness of cost containment efforts.

3. The Division should develop a policy regarding enrollment fraud, and make the policy widely known to employees to deter its occurrence.

Fife Symington
Governor

J. ELLIOTT HIBBS
Director

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PERSONNEL DIVISION
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October 6, 1993

Douglas R. Norton
Auditor General
2910 N. 44th Street, Suite 410
Phoenix, Arizona 85013

Dear Mr. Norton:

Enclosed are our comments on the revised sunset report of the Personnel Division.

We wish to thank you for the cooperation your sunset team exhibited in developing the sunset report. The Personnel Division is appreciative of the efforts made by the team to understand the complexities of the State's personnel system.

Please do not hesitate to contact us if you have any questions.

Sincerely,

J. Elliott Hibbs
Director

William Bell
Assistant Director
for Personnel

JEH:WB/crs

Enclosure

SUMMARY

The Department of Administration believes that the recommendations in the audit report represent the customer oriented direction defined in the Department's vision and mission adopted in November 1992. We, therefore, generally support the directions outlined.

The performance audit encompassed the Personnel Division's three primary service areas, Employee Health Benefits Programs, Employment, and Classification/Compensation. The Division actively supports many of the recommendations contained in the report. Several improvements not noted in the audit already have occurred, while others are under development, with final implementation in some cases subject to funding approval.

Approximately two years ago, the newly appointed personnel director and his management team embarked upon preliminary review of the service delivery and processes performed by the Personnel Division. This review led to the conclusion that major reforms and process modifications would be necessary before the Division would be able to proactively address the existing deficiencies. For example, before any consideration relative to making a transition to division-wide automation could begin, the entire building had to be rewired; the antiquated employment system that was being used needed to be replaced; user friendly, customer oriented service delivery processes needed to be encouraged and developed. A final five-year strategic plan to create a modern, state-of-the-art personnel system will be completed shortly. This will guide efforts to streamline the system in coming years.

Significant strides already have been made to enhance existing processes, and more aggressive approaches are being developed for implementation with available resources. These are identified in our response to each of the findings and recommendations as appropriate.

Finding I: The state needs to redesign its outmoded hiring system.

Recommendation 1: DOA Personnel should begin a comprehensive reform of the State hiring system, including shifting Personnel's role from rule enforcement to service; reviewing statutes and preparing recommendations for the Legislature; and redrafting the Personnel Rules.

Response: The Division began to design and champion an optimum statewide hiring process in cooperation with the Governor's Office of Excellence in December of 1992. Three pilot projects to assist in the implementation of this optimum hiring process are ongoing, with start up of the new system projected to occur in early 1994.

The first pilot is a proactive partnering project involving five agencies and the Personnel Division. Through the use of charters signed between an agency and the Personnel Division, DOA will decentralize components of the hiring process by delegating to the agency those components agreed to in the charters. The Personnel Division will house Human Resource experts who will provide advice, guidance, technical information and training as requested, and serve in a consultative and professional administrative role.

The second project under development will introduce a change in the processing of applications and agency requisitions to fill vacant positions. A state-of-the-art software program that scans resumes through artificial intelligence will be purchased. An applicant will use a simplified application as a cover sheet to a resume; one application/resume for any job in State Service will be used; for some jobs a supplemental form will be used instead of a resume. Agency supervisors will be able to electronically submit a requisition and initiate a paperless transaction. Based on criteria established by a hiring supervisor in cooperation with a personnel professional, a new software program can automatically review all available resumes and general a short list of candidates who meet the criteria.

The third project will be an automated link between a Department of Economic Security Job Service Office and the Personnel Division to establish on-line job information and application processing. The Job Service Office will have updated information on jobs and vacancies in State Service. Applications/ resumes will be directly scanned into the Personnel Division's candidate pool and matched to any unfilled requisition.

To address necessary revisions to the Personnel Rules as a result of the new process to be implemented, a task team is reviewing the statutes and rules applicable to State Service employment.

Recommendation 2: In the meantime, Personnel should relax operating practices and rules to increase service to, and participation of, State agencies in the hiring process. Particularly, Personnel should allow: the design of supplemental applications by agencies; an expedient method to update inappropriate job qualifications; maximum supervisor participation in candidate evaluation; correction of candidate scores; access to additional candidate names; prompt purging of names from registers; and targeted recruiting at colleges or job fairs.

Response: We concur with this recommendation to facilitate and enhance agency involvement in the hiring process and have welcomed such participation in the past. To further improve the quality of service, we have taken steps to encourage agency participation by:

-Continuing agency involvement in the development of recruitment supplements. In the past two years, supplements for fifteen classifications have been developed with the assistance of agency subject matter experts.

-Deriving job qualifications from up-dated PDQs rather than from the class specifications.

-Inviting hiring supervisors to participate in the evaluation of applications.

-Directing analysts to expedite the current process when candidate score correction is warranted.

-Inviting hiring supervisors to review a register prior to a hiring list being issued; or, when register review indicates need, placing additional names on the hiring list.

-Raising the priority of purging names from registers.

-Encouraging agency collaboration with the Personnel Division at colleges and job fairs.

Finding II: DOA needs to address fundamental problems with the State's classification system.

Recommendation 1: DOA should develop a plan to establish the future purpose and direction of the state's classification system. This plan should include: what State government hopes to achieve from it's classification system; the strategies to reach these goals, including the most appropriate framework and method of job evaluation; and an approach to obtain legislative support for the need to maintain and enhance the classification system.

Response: In early 1992 the Governor's Office of Excellence recommended the formation of a Position Correlation Studies Task Group made up of Coopers & Lybrand and Personnel Division staff. This group noted many of the same concerns with the current method of classification that were identified in this performance audit, i.e., it is too subjective; is slow and lacking in responsiveness; is not universally understood or applied; is easily manipulated; uses internally inconsistent-job matching; and is labor intensive. Identification of the concerns changed the project focus from updating and improving the current classification system to recommending a new job evaluation system, which would be the basis for a new classification system.

The Position Correlation Studies Group generally agreed that all classification systems have strong and weak points, but a point factor method of job evaluation would address many of the current concerns with the existing system.

The Position Correlation Studies Group used current state job classifications to test the recommended point factor system, the Oliver System, before Coopers & Lybrand made their final report and recommendation to the DOA Director in September 1993. Coopers & Lybrand also recommended that the new classification system be implemented in concert with an aggressive salary administration plan in order for it to be effective. The DOA Personnel Division has strongly emphasized the need to address salary/compensation problems in order to maintain or implement any sound classification system. The Coopers & Lybrand recommendation, as well as the Performance Audit Recommendation, reiterate that no classification system will be effective until salary issues are addressed.

The Department supports the recommendation and will develop an approach to obtain necessary legislative support to establish, maintain and enhance the classification system.

Finding III: DOA should improve efforts to inform decision makers on salary issues.

Recommendation 1: The Legislature should consider amending A.R.S. 41-763.5 to require that the annual salary recommendation be made to the Governor and the Legislature by early fall of each year, and that the recommendation include alternative approaches to compensation issues, in order to address the State's compensation problems.

and

Recommendation 2: DOA should prepare recommended salary adjustments based on the results of its analysis and allow policymakers to determine whether the salary issues will become budget priorities.

Response: Budget and salary recommendations are inextricably intertwined. The Legislature receives the Joint Governmental Salary Survey as soon as it is printed, usually six to eight weeks prior to the annual recommendation. In the annual recommendation, the Department always identifies the existing salary gap between the State and other employers, consistently advocates for competitive salaries and urges that the gap be narrowed. We have offered alternative options for addressing inequities; however, no specific proposals can be offered without considering the ability to fund the proposal.

If the Legislature moves forward the date for the Annual Recommendation, the DOA will adjust the Joint Governmental Salary Survey schedule as necessary in order to comply with legislative requirements. The customary advance distribution of the survey results to the Legislature and survey participants shall continue. The Personnel Division is currently reviewing alternatives to collect, analyze, and prepare for publication the Joint Governmental Salary Survey in an abbreviated time period. It is anticipated that this effort will streamline the process.

Finding IV: DOA needs to more proactively manage its employee health care benefits program.

Recommendation 1: In making major policy decisions, the Division should include employees and legislature in the decision making process to help define goals for the health insurance plans.

Response: The Department will be working closely with the Benefits Oversight Committee, a legislative group established last session. Additionally, the Division has established the Employees' Benefits Advisory Committee, an employee focus group. This body of 28 employee members (nominated by their respective agencies) will meet bi-monthly to discuss employee benefits. The partnership between the Division and these two committees will provide a solid

forum for obtaining suggestions for benefit changes as well as to obtain feedback on potential changes the Department may consider.

Recommendation 2: The Division should establish the design of the health insurance plans prior to beginning the procurement process, and include the specifics of the plan design in the RFP.

Response: The Division agrees with the concept of the recommendation, but supports retention of flexibility in an RFP to allow bidders to propose potentially innovative alternatives and/or viable design recommendations. The Division is currently in the process of developing a survey of the major employers in Arizona for use in future RFP development. In this manner, the competitiveness of the State's benefits plans will be maintained.

Recommendation 3: The Division should improve communications with employees on the benefits programs.

Response: The Division agrees that communication is extremely important to the success of the benefits plans. Since January 1993, the monthly newsletter "For Your Health and Benefits" has been published and distributed to all employees. In addition to the regularly scheduled meetings that are held throughout the state during each Open Enrollment period, the Benefits Section implemented the "On the Road" program. This entailed monthly visits to various locations to provide personal interaction between employees, D.O.A. benefits professionals and the carriers. These meetings have been well received and have provided an additional forum to address employee concerns and provide education about benefits. The Division is also in the process of producing personalized employee benefits statements to be delivered to employees in early 1994. The focus group identified in the response to Recommendation 1 is anticipated to serve as an additional communications conduit to agencies and groups they represent.

Recommendation 4: The Division must work to obtain utilization information from the carriers and use this information to project potential premium increases and determine their validity.

Response: The Division has proactively monitored available information since 1983. Meetings have been held with the carriers to facilitate the development of relevant reports. Analysis of utilization data is used as an integral component in the RFP process. While we initially experienced difficulties due to transition, all carrier utilization reports currently are meeting the reporting requirements on a timely basis.

Recommendation 5: The Division must monitor the health insurance program and evaluate the insurance carriers for achievement of performance standards, assessing contractual penalties for nonperformance.

Response: The Division does monitor the receipt and validity of performance reports. An audit of the carriers was requested in the Spring of 1993 to validate these reports. Penalties will be assessed for nonperformance, as appropriate. However, if there are extenuating circumstances beyond the carriers' control, there may be more appropriate means of resolving the issues.

Finding V: The Division should implement mechanisms to curb escalating health care benefit costs.

Recommendation 1: The Division should consider implementing cost containment techniques used by other employers, including carving out of mental health or prescription drug programs, developing a comprehensive wellness program and conducting eligibility audits.

Response: The State has and will continue to implement cost containment techniques. It must be considered, however, that many of those employers cited have done less to control costs to date than the State has accomplished as an ongoing practice. Therefore, many of these programs would be less useful for the State than they are for employers who have implemented them. For example, the prescription programs currently in place offer as great a savings as would a stand-alone plan. This is accomplished through the discounts negotiated by the carriers, the use of generic drugs and formularies within the plans. Generally, carved-out mental health plans offer a more comprehensive level of benefits than are available under current state plans. A study performed by the Wyatt Company determined that the start up costs for implementation of a carved-out mental health plan for the state would negate any potential savings. Additionally, the State's wellness program is in the process of being further developed. Following the development of a policy regarding eligibility enrollment fraud, eligibility audits will be conducted.

Recommendation 2: The Division should obtain adequate expenditure data on the health plans in order to target and measure the effectiveness of cost containment efforts.

Response: The Division continuously has utilized expenditure data to target cost containment efforts and validate renewal requests. For example, in response to an analysis of the number of low birth weight babies and associated complications, the Division has developed a comprehensive prenatal care/education program in conjunction with the State's carriers. Efforts are ongoing to improve the quality of the data received from the carriers.

Recommendation 3: The Division should develop a policy regarding enrollment fraud and make the policy widely known to employees to deter its occurrence.

Response: The Division agrees and is developing such a policy.