Employee Gainsharing Program

Special Review

January 25, 2018

OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA

State of Minnesota

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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA • James Nobles, Legislative Auditor

January 25, 2018

Members of the Legislative Audit Commission:

This report examines a requirement in state law for the Minnesota Department of Management and Budget (MMB) to implement a "gainsharing" program. Under such a program, certain state employees who suggest cost-saving ideas could be eligible to share a portion of the savings. We conducted our review at the request of the chair of the House State Government Finance Committee.

We found that MMB has not implemented the program required by law. At various times, MMB has said that the gainsharing law would be unworkable or expensive to implement, or that the law does not require MMB to implement a program in which employee rewards are based on cost savings. However, we think the mandate in law is clear, and MMB should take immediate steps to comply. If implementation problems arise, MMB can highlight these in its statutorily required biannual reports to the Legislature on the program.

We received full cooperation from MMB as we prepared this report.

Sincerely,

James Nobles
Legislative Auditor

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Director, Special Reviews

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TABLE OF CONTENTS

CONCLUSION

The Minnesota Department of Management and Budget (MMB) has not implemented a "gainsharing" program that has been required in Minnesota law since 2011. Under such a program, state employees who identify cost-saving improvements in state government would be eligible for one-time financial awards. The maximum award is 10 percent of the documented first-year savings, up to $50,000. MMB has raised some legitimate questions about how to properly implement such a program. However, MMB maintains that the law does not require it to implement a cost-savings-based gainsharing program, and we disagree. MMB has not developed formal policies for a gainsharing program or even an application form. The department asserted in 2017 that such a program would cost $1.6 million to implement annually, which was much different from the net cost savings the department estimated when the law passed in 2011.

We recommend that the department comply with the law and implement a gainsharing program. MMB is required by law to report twice yearly on the program's status, so it will have opportunities to periodically convey any implementation problems to legislators. MMB can try to persuade the Legislature that it needs additional funds to cover the administrative costs of implementing gainsharing, but the 2017 Legislature already considered this issue and did not make an appropriation for this purpose.

Our report also recommends that the Legislature clarify the relationship between the gainsharing statute and other statutes that have provisions for employee compensation. This could affect, for example, whether state employee contracts may have gainsharing compensation provisions that differ from those in the gainsharing statute.

BACKGROUND

"Gainsharing" refers to a type of financial incentive for employees to identify cost-saving ideas. As the term suggests, this concept is based on the notion that employees who help their organizations save money or profit financially should share in the gains, receiving financial bonuses that represent a portion of the savings or profits that would otherwise accrue to the organization. Gainsharing strategies have been used for decades by some private and public organizations.

Minnesota law has mandated or authorized the implementation of gainsharing in state government on three occasions. First, the 1995 Legislature required the development of a gainsharing pilot program in one state agency.[1] The Legislature directed the Minnesota Department of Employee Relations to offer its employees "rewards" for their suggestions for improving agency operations. For example, it required the department to give $500 to $2,500 bonuses to certain categories of employees who suggested and helped implement (1) cost savings

[1] *Laws of Minnesota* 1995, chapter 248, art. 13, sec. 3.

of at least $25,000 or (2) "significant and objectively measurable efficiencies in services that the agency provides to its customers or clients."[2] This program was in effect for only a two-year period. During that time, a team of Department of Employee Relations staff developed suggestions for improving the open enrollment process for state employee health insurance, and the department estimated that these suggestions would save the state about $288,000 per year.[3] The 1997 Legislature did not amend state law to require continued use of a gainsharing program in this or other state agencies, and this version of a state gainsharing program ended.

Second, the 1998 Legislature authorized the Metropolitan Council to implement a gainsharing program. The Council could develop "service implementation plans," and Council employees could be compensated "for any demonstrable reduction in the cost of service."[4] The compensation had to be negotiated with employee representatives under the state's Public Employment Labor Relations Act, and total compensation could not exceed the actual cost reduction over a one-year period. The 2003 Legislature repealed this law.[5]

The third instance of a statutory provision for gainsharing is the focus of this report. The 2011 Legislature required MMB to develop a state employee gainsharing program. Unlike the earlier provisions, the 2011 requirement was not limited to a single agency. The statutory requirement for implementation of a gainsharing program remains in effect today.

This report addresses two questions:

(1) In the period from the law's passage in 2011 to the 2017 legislative session, did MMB comply with the statutory requirement to implement a state employee gainsharing program?

(2) How is MMB implementing the statutory requirement for a gainsharing program in response to the 2017 Legislature's directives?

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[2] *Ibid*.

[3] Minnesota Department of Employee Relations, *Gainsharing Pilot Program* (St. Paul, undated). Neither this report nor another issued by the Department of Employee Relations on this project indicated how much money was paid to participating employees in bonuses.

[4] *Laws of Minnesota* 1998, chapter 381, sec. 1, as codified in *Minnesota Statutes* 1998, 473.1295.

[5] *Laws of Minnesota* 2003, chapter 16, sec. 11. To our knowledge, the Metropolitan Council did not issue any public reports to the Legislature regarding the implementation of its gainsharing program. MMB staff told us the statute was repealed because it created internal conflict among employees.

QUESTION 1: Did MMB comply with a 2011 statutory requirement to implement a state employee gainsharing program?

In 2011, the Minnesota Legislature passed a law that directed the executive branch to create an "employee gainsharing system." The law said:

> The [Commissioner of the Department of Management and Budget] shall establish a program to provide onetime bonus compensation to state employees for efforts made to reduce the costs of operating state government or for ways of providing better or more efficient state services. The commissioner may authorize an executive branch appointing authority to make a onetime award to an employee or group of employees whose suggestion or involvement in a project is determined by the commissioner to have resulted in documented cost-savings to the state.[6]

The law required the commissioner to establish guidelines for the program before authorizing awards pursuant to this statute. As amended by the 2012 Legislature, the law says these guidelines must include, but are not limited to, the following:

- The maximum award is 10 percent of the documented savings in the first fiscal year in which the savings are realized, up to $50,000.
- The award must be paid from the appropriation to which the savings accrued.
- Employees whose primary job responsibility is to identify cost savings or ways of providing better or more efficient state services are generally not eligible for bonus compensation, except in extraordinary circumstances defined by the commissioner.[7]

Following the 2012 amendment, this law was not amended by the Legislature until 2017. We discuss the 2017 amendments later.

Following passage of the gainsharing legislation in 2011, the Minnesota Department of Management and Budget (MMB) did not take steps to implement the program required by law.

The Office of the Legislative Auditor first explored whether the gainsharing program had been implemented when it investigated a state employee complaint in 2014. The employee had made

[6] *Laws of Minnesota* 2011, First Special Session, chapter 10, art. 3, sec. 25, as codified in *Minnesota Statutes* 2017, 16A.90.

[7] *Ibid.* When the gainsharing legislation passed in 2011, the maximum award was $1,000 per individual or $2,500 per group of employees. The 2012 Legislature made one change to the gainsharing law, specifying a maximum award of $50,000; see *Laws of Minnesota* 2012, chapter 205, sec. 1, as codified in *Minnesota Statutes* 2017, 16A.90. The amended law did not indicate separate maximums for individuals or groups of employees.

a suggestion to her agency for improvements in a state process, and she believed she should be compensated for the resulting cost savings. When she contacted MMB to ask about the gainsharing program authorized in statute, she was told:

> [T]he Gainsharing program is not yet implemented and will not be any time soon. As a result, the answers to your questions are clear—no agencies have or are participating in the program. Further, no employees have received compensation from this program.[8]

When our office followed up on the employee complaint, we asked MMB about the status of the gainsharing program. In March 2014, an MMB official told us: "MMB has not yet implemented the program as the agency continues…to seek what the agency would consider a fair implementation plan."[9]

Recently, we discussed the gainsharing program with the person who was MMB commissioner when the 2011 gainsharing law passed. He told us "we didn't implement it" before he left the agency in December 2014. He said MMB had unresolved questions about how to implement gainsharing, and the agency instead focused on ways to improve feedback to state employees and implement an "Achievement Awards" program. MMB had adopted a policy in February 2012 that established the Achievement Awards program, which allowed state agencies to recognize and reward employees for outstanding performance. The Achievement Awards program remains in effect today. We determined that, for fiscal years 2012 through 2017, agencies paid for a total of more than $11 million in employee bonuses through the Achievement Awards program.

In 2015, the Legislature passed legislation that required the MMB Commissioner to report by July 2015 on the status of the gainsharing program.[10] The resulting MMB report said, "The State of Minnesota executive branch agencies have approached gainsharing through Achievement Awards."[11] But, as indicated in the box on the next page, the gainsharing program outlined in state law was different in important ways from the Achievement Awards program MMB established.

We reviewed the statewide policies MMB adopted in 2012 for its Achievement Awards program, as well as a sample of the policies that were subsequently adopted by individual state agencies.[12] None of these MMB or agency policies reference *Minnesota Statutes*, 16A.90, which required the creation of a gainsharing program. Also, the gainsharing statute focuses on agency

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[8] Joel Ludwigson, Data Practices Compliance Official, Minnesota Department of Management and Budget, e-mail message to the requesting employee, November 22, 2013.

[9] John Pollard, Legislative and Communications Director, Minnesota Department of Management and Budget, e-mail to Pat Ryan, Office of the Legislative Auditor, March 14, 2014.

[10] *Laws of Minnesota* 2015, chapter 77, art. 1, sec. 13.

[11] Minnesota Department of Management and Budget, *Gainsharing: Report to the Legislature* (St. Paul, July 15, 2015), 4.

[12] Minnesota Department of Management and Budget, Human Relations/Labor Relations Policy 1420, "Employee Recognition and Achievement Awards," initially issued February 10, 2012. The issuance of this policy ended a period of several years—starting in late 2008—during which executive branch officials had prohibited state agencies from giving achievement-related awards to their employees.

improvements that result in verifiable cost savings, while the Achievement Awards program rewards employees using a broader definition of employee performance.

Key Differences Between Gainsharing Program Mandated by State Law and MMB's Achievement Awards Program

Program Elements	Gainsharing	Achievement Awards
Source of funding	State appropriations for the programs in which the documented cost savings occurred.	Existing state agency operating budgets.
Size of awards	Maximum of 10 percent of documented first-year cost savings, up to $50,000 per award.	May vary by agency and bargaining unit. One unit (AFSCME) does not allow achievement awards. Most awards have been $1,000 or less.
Basis of awards	Based on "documented savings in the first fiscal year in which the savings are realized."	Based on outstanding employee performance. MMB policy does not specifically mention cost savings.

State law required MMB's 2015 report on gainsharing to discuss what results the program had achieved, any recommendations for legislative changes, and how the program had been promoted. MMB's report indicated the number and total dollar value of awards that had been made under the Achievement Awards program; it did not discuss what results (such as program improvements or cost savings) this program had achieved. In addition, MMB's report did not offer any recommendations for changes to the gainsharing law, although it discussed challenges posed by the law.[13] Finally, the report's only discussion of program promotion was a statement that said that MMB's Achievement Awards policy and procedures "promote achievement awards as an essential element for creating and maintaining a culture that recognizes innovation and creativity, reduces waste, creates cost savings, makes government work better, and recognizes the outstanding work of State employees."[14] Overall, MMB's 2015 report focused on implementation of its Achievement Awards program rather than the type of cost-savings-based gainsharing program outlined in state law.

In 2017, the MMB Deputy Commissioner for Enterprise Human Capital testified in a Minnesota House of Representatives committee about the gainsharing program. He said that MMB had implemented the Achievement Awards program, which he said was a type of gainsharing program. "We believe that our program comports with the law," he said. In a letter sent to the committee following the hearing, the Deputy Commissioner said MMB's Achievement Awards program met the intent but not the specific provisions of the gainsharing statute:

> To clarify, MMB and other state agencies have implemented a program that realizes the legislative intent of the statute. The plain language of the statute is

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[13] Challenges discussed in MMB's 2015 report included: the difficulty measuring cost savings; constraints to recouping certain savings, such as those in federally funded programs; and questions about whether financial rewards would adversely affect employee motivation.

[14] Minnesota Department of Management and Budget, *Gainsharing: Report to the Legislature*, 3.

> unworkable…for a variety of reasons, primarily related to the nature of calculating often complex, long-term savings realized from employee input and providing fair bonuses based on specifically documented savings, among other reasons.[15]

Likewise, a letter to a legislator from the MMB Commissioner described the gainsharing statute as "unworkable" but said the Achievement Awards program was accomplishing the goals of the gainsharing statute:

> The amount of resources allocated to Achievement Awards does not equate to a specific percentage of savings accomplished. The requirement in [Minnesota Statutes] 16A.90 of "awarding documented savings in the first fiscal year in which the savings are realized" from each agency's appropriation is unworkable as written. Savings are most often spread over time, cannot be budgeted from an agency's appropriation without funding invested to create new systems to make the savings determinations, and often savings from the best ideas cannot be specifically [documented] at all. Achievement Awards has been implemented as a way to accomplish the goals of gainsharing in a proven, cost effective way.[16]

The 2017 Legislature amended the state gainsharing statute. The Legislature did not change the substantive requirements that already existed in the law. But, to emphasize the need to implement a gainsharing program different from the Achievement Awards program, the Legislature added the following language: "The program required by this section must be in addition to any existing monetary or nonmonetary performance-based recognition programs for state employees, including achievement awards, continuous improvement awards, and general employee recognitions."[17] To emphasize the mandatory nature of the gainsharing program, the Legislature added a subdivision title in the statute that said, "Commissioner must establish program."[18] In addition, the Legislature required MMB to report twice yearly on the implementation of the gainsharing statute.[19]

Overall, we concluded that, as of the 2017 legislative session, MMB had not complied with the requirements of the gainsharing law. In recent years, MMB has implemented discretionary programs to recognize employee performance, such as Achievement Awards, but it did not implement the cost-savings-based gainsharing program mandated in 2011 by state statute. MMB officials have described the gainsharing law as "unworkable," but they did not offer specific suggestions for changes in a 2015 report to the Legislature. In the next section, we examine MMB's actions since the 2017 legislative session.

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[15] Edwin Hudson, Deputy Commissioner, Minnesota Department of Management and Budget, letter to Representative Sarah Anderson, Chair, and members of the House State Government Finance Committee, March 16, 2017.

[16] Myron Frans, Commissioner, Minnesota Department of Management and Budget, letter to Representative Jim Nash, May 2, 2017.

[17] *Laws of Minnesota* 2017, First Special Session, chapter 4, art. 2, sec. 19, as codified in *Minnesota Statutes* 2017, 16A.90, subd. 1.

[18] *Ibid*.

[19] *Ibid.*, as codified in *Minnesota Statutes* 2017, 16A.90, subd. 2.

QUESTION 2: How is MMB implementing gainsharing in response to the 2017 Legislature's directives?

As noted in the previous section, the 2017 Legislature amended the gainsharing statute. Specifically, the Legislature added language to reiterate MMB's obligation to implement a program consistent with the existing directives of the gainsharing statute and different from the Achievement Awards program. Also, to improve accountability, the Legislature required MMB to report twice annually on its implementation efforts. The law requires MMB to report on:

- Program guidelines established by (or under consideration by) MMB.
- Methods of promoting the program to state employees.
- Results of the gainsharing program, including the number of employees who submitted suggestions, descriptions of each suggestion, the amount of bonus compensation awarded under the program, and the total documented cost savings accruing to agencies as a result of suggestions for which bonuses were granted.
- Any recommendations for legislative changes that would improve the program.[20]

MMB was required to prepare the first of its progress reports by August 1, 2017, and it did so.[21]

The Minnesota Department of Management and Budget does not intend to implement the cost-savings-based gainsharing program specified in *Minnesota Statutes* 2017, 16A.90. The department does not believe the law mandates such a program nor that the Legislature has provided adequate funding.

Below, we discuss MMB's concerns about the gainsharing statute, program funding, and other issues.

MMB Concerns About the Gainsharing Statute

In late 2017, MMB officials told us that, in their opinion, the law does not require them to implement a gainsharing program in which the maximum awards are based on documented cost savings. Specifically, they cited the law's use of the word "may" in a portion of the statute and said this gives MMB latitude to decide what type of program to implement.

Exhibit 1 shows the current language of the gainsharing statute, except for its reporting requirements. We have highlighted and underlined the words that are directive ("must," "shall," and "required") and permissive ("may"). We disagree with MMB's interpretation of this statute.

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[20] *Ibid.*

[21] Minnesota Department of Management and Budget, *State Employee Gainsharing: Report to the Legislature* (St. Paul, August 1, 2017).

In our view, the language clearly requires development of an employee award program that is distinct from MMB's Achievement Awards program. The statute contains one word of permissive language, which relates to the method by which the gainsharing program is implemented.[22] We think the actions of the 2017 Legislature were clearly intended to underscore the requirement to implement a gainsharing program that legislators thought was already mandated.

Exhibit 1: Directive and Permissive Language in the State Gainsharing Statute

16A.90 EMPLOYEE GAINSHARING SYSTEM.

Subdivision 1. **Commissioner must establish program.** (a) The commissioner shall establish a program to provide onetime bonus compensation to state employees for efforts made to reduce the costs of operating state government or for ways of providing better or more efficient state services. The commissioner may authorize an executive branch appointing authority to make a onetime award to an employee or group of employees whose suggestion or involvement in a project is determined by the commissioner to have resulted in documented cost-savings to the state. Before authorizing awards under this section, the commissioner shall establish guidelines for the program including but not limited to:

(1) the maximum award is ten percent of the documented savings in the first fiscal year in which the savings are realized up to $50,000;

(2) the award must be paid from the appropriation to which the savings accrued; and

(3) employees whose primary job responsibility is to identify cost savings or ways of providing better or more efficient state services are generally not eligible for bonus compensation under this section except in extraordinary circumstances as defined by the commissioner.

(b) The program required by this section must be in addition to any existing monetary or nonmonetary performance-based recognition programs for state employees, including achievement awards, continuous improvement awards, and general employee recognitions.

NOTE: The second subdivision of this statute (not shown here) relates solely to required biannual reporting on the status of the gainsharing program.

SOURCE: *Minnesota Statutes* 2017, 16A.90, subd. 1.

In addition, MMB has not yet established policies for implementing the gainsharing program. MMB's August 2017 report discussed ideas for gainsharing program implementation in several areas: eligibility criteria for employees; the application and selection process; methods for promoting the program to employees; and the process for determining cost savings associated with an employee suggestion. But, unlike the Achievement Awards program, MMB has not adopted formal, definitive policies for the gainsharing program. For example:

- Regarding employee eligibility for gainsharing, MMB indicated in its August 2017 report that it was leaning toward making employees of the Minnesota State higher education system eligible to participate in a gainsharing program; however, the report offered no definitive statement. Also, the report identified categories of employee suggestions that

[22] By our interpretation, the word "may" allows the commissioner (or the commissioner's designee in an agency) to decide whether or not to authorize a gainsharing award, in cases for which cost savings have been documented.

are ineligible for awards in other states' gainsharing programs, but it did not specify a definitive policy for Minnesota.

- MMB's August 2017 report mentioned the need to develop a gainsharing application form for employees, and it suggested certain elements that the form should include. However, MMB has not adopted an application form or process.

- Regarding promotion of the gainsharing program to employees, MMB's progress report said "executive branch agencies must develop strategies to communicate the parameters of the program and process…to their employees." The report suggests some options for doing this. However, the progress report does not specify a clear role for MMB in program promotion, and MMB does not have a written policy regarding how agencies should promote the program.

Overall, MMB's August 2017 progress report did not lay out steps or a timetable for implementation of the program. MMB officials told us they do not intend to proceed with additional steps until the Legislature addresses funding for the program or MMB's other implementation concerns.

MMB Concerns About Funding

MMB's August 2017 progress report said that the cost of implementing gainsharing would be at least $1.6 million annually.[23] MMB noted that it received no appropriation to develop and administer the program. It also said there are no data to ensure that the program's savings will offset its costs, and it referred to gainsharing as an "unfunded mandate."[24]

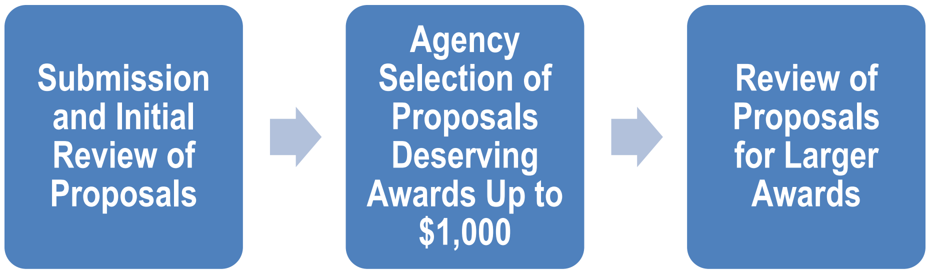
Exhibit 2 shows MMB's estimates of the annual cost for state employees, agency leadership, and MMB to develop and review gainsharing proposals. In addition to the costs shown in Exhibit 2, MMB estimated that the annual costs for developing twice-a-year reports to the Legislature on gainsharing would be $227,000, and that the cost of a staff person to administer the gainsharing program would be $50,000.

For several reasons, legislators should question MMB's estimates of the cost of implementing gainsharing. First, when the 2011 Legislature passed the statutory requirement for MMB to develop a gainsharing program, MMB's analysis of the fiscal impact of this requirement was much different from the estimate MMB prepared in 2017. In 2011, MMB estimated that the gainsharing law would result in net savings to the state of nearly $600,000 per year, compared with its 2017 estimate of a $1.6 million annual cost. This is because the 2011 estimate assumed that gainsharing would result in $1 million in cost savings per year (the 2017 estimate made no assumption regarding the amount of cost savings), and MMB's 2011 estimate assumed much

[23] The cost estimates in the August 2017 report were based on the "fiscal notes" MMB prepared in Spring 2017 that estimated the cost of gainsharing legislation under consideration by the Legislature.

[24] Minnesota Department of Management and Budget, *State Employee Gainsharing: Report to the Legislature*, 18.

Exhibit 2: Minnesota Department of Management and Budget's Estimate of Costs for Developing and Reviewing Employee Gainsharing Proposals



	Submission and Initial Review of Proposals	Agency Selection of Proposals Deserving Awards Up to $1,000	Review of Proposals for Larger Awards
MMB Cost Estimate:	$845,000	$525,000	$2,000
MMB Assumptions	• 526 proposals submitted by eligible state employees (1 submission per 100 employees). • 26,300 total hours spent developing and reviewing proposals at $32.13 per hour.	• 105 proposals forwarded to an Agency Review Committee (personnel, budget, communications, and executive staff). • 11,232 total hours spent reviewing proposals (107 hours per proposal) at $46.73 per hour.	• 26 proposals considered by MMB Enterprise Gainsharing Committee for awards larger than $1,000. • 52 total hours spent reviewing proposals (2 hours per proposal) at $46.73 per hour.

NOTE: This exhibit does not include estimated annual costs for MMB to develop twice-a-year reports to the Legislature on gainsharing ($227,000) and employ a staff person to administer the gainsharing program ($50,000).

SOURCE: Office of the Legislative Auditor, based on review of Minnesota Department of Management and Budget, *State Employee Gainsharing: Report to the Legislature* (St. Paul, August 1, 2017).

lower staffing costs to implement the legislation than MMB's 2017 estimate.[25] MMB told us recently that its 2011 fiscal note was based on the expectation that it would implement a broad-based employee recognition program, not a cost-savings-based gainsharing program.

Second, some of the assumptions underlying MMB's 2017 fiscal estimates for the gainsharing legislation are questionable. For example, in its August 2017 report, MMB said that the total annual cost to prepare its required two reports per year to the Legislature on the gainsharing program would be $227,000. MMB said that its own staff would spend 720 hours per year on this task, while staff in other agencies would spend 6,000 hours. MMB intends to require state

[25] It is unclear to us why the fiscal notes for the 2017 gainsharing legislation included costs for implementing gainsharing, given that state law already contained a requirement for MMB to implement gainsharing. Fiscal notes are supposed to estimate any new fiscal impacts that would result from legislation, not the costs of implementing current laws. On the other hand, it was appropriate for the 2017 fiscal notes to estimate the fiscal impact of new reporting requirements that 2017 legislation proposed to add to the gainsharing statute.

agencies to report monthly to MMB on gainsharing projects, although the legislation did not require a specific frequency of agency reporting to MMB. Consequently, MMB's estimated total cost for implementing the public reporting portion of the legislation did not decrease even after the House and Senate amended their 2017 bills to require 2 MMB reports to the Legislature annually instead of the 12 reports annually required in the original bills.[26]

Third, while there are undoubtedly administrative costs involved with the implementation of gainsharing, agencies have also incurred costs to implement other programs instead of gainsharing. After the 2011 Legislature required MMB to implement gainsharing, MMB implemented employee award programs of its own choosing. Those programs, such as the Achievement Awards program, have costs that MMB and state agencies have incurred, without additional state appropriations. As noted earlier, agencies paid more than $11 million in employee Achievement Awards bonuses over a six-year period, and this does not include costs spent by agencies or MMB administering the Achievement Awards program.

Finally, the gainsharing statute is not very prescriptive regarding the executive branch process for developing and reviewing gainsharing applications, and this leaves a lot of latitude for estimating the law's fiscal impacts. MMB has estimated that more than 37,000 staff hours per year would be spent on these activities. We recognize the difficulty of estimating such hours before a program is in place. However, the 2017 Legislature reviewed fiscal notes with MMB's estimates when it considered bills to amend the gainsharing statute, and it chose not to appropriate additional money to cover the gainsharing program's administrative costs.

Other MMB Concerns

MMB's August 2017 progress report to the Legislature expressed "numerous significant concerns" about gainsharing. Besides the funding concerns discussed above, MMB said:

- "[U]nlike sharing profits in the private sector, government budgets are more inflexible and cannot easily calculate and budget for savings."

- "[S]ocial science studies repeatedly conclude that for all but simple and routine tasks, financial rewards designed to motivate performance actually have the opposite effect." MMB said that all other states with gainsharing programs cap their awards at much less than Minnesota's maximum award of $50,000, and smaller awards ($1,000 to $2,000) have "been found to be sufficient."

- "The motivation of a bonus award of up to $50,000 and the designation of certain employees who are employed specifically to find savings as ineligible for the program has the potential to increase risk of waste and abuse….A gainsharing program creates a

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[26] MMB told us that it wants to receive monthly agency reports on gainsharing so that there will be more MMB oversight of agencies' estimates of cost savings. MMB said that this will help to ensure that data presented to the MMB commissioner for award decisions will withstand public scrutiny. MMB said that it considered the experience of three states (Georgia, Indiana, and West Virginia) when deciding on its internal reporting process.

> risk of ineligible employees using their expertise in conjunction with eligible employees to submit ideas and then unjustly benefit from the award."[27]

Some of MMB's concerns about gainsharing are worth considering. We agree, for example, that it may be difficult to determine the cost savings in state government that would result from the implementation of some employee suggestions, and that it is important to implement gainsharing programs with proper attention to the risk of fraud.

However, we also think it would be feasible to implement a gainsharing program of the type specified in Minnesota law. California has administered a state employee suggestion program for more than 60 years, and—contrary to MMB's assertion that all states cap their awards at levels much less than Minnesota—California's maximum award is $50,000.[28] California's program—like the one mandated in Minnesota—pays employee awards out of agency cost savings.[29] In addition, a review of local government practices said, "Many local governments across the country have ventured successfully into gainsharing."[30]

While the development of policies and procedures for a workable gainsharing program may pose challenges, the gainsharing concept has proponents. For example, according to two leading authors on public management:

> Gainsharing offers a win for everyone. It provides a huge incentive for better performance without costing the taxpayers a dime; in fact, the taxpayers save money. In an era of permanent fiscal crisis, every public organization should adopt it.[31]

In addition, research has found that workplace incentives—including financial ones—can contribute to positive results. While MMB correctly notes that financial incentives can reduce what researchers call "intrinsic motivation," a summary of well-designed studies that examined the impact of incentives on performance concluded:

> The main result of this study is strong support for the claims that incentives can significantly increase work performance when they are carefully implemented and performance is measured before and during incentive programs.

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[27] Minnesota Department of Management and Budget, *State Employee Gainsharing: Report to the Legislature*, 18.

[28] We did not conduct an exhaustive review of gainsharing or employee suggestion programs in other states, but we are aware of one other state (New York) that operates a program with a maximum payout per suggestion of $50,000. North Carolina limits the payouts per individual employee to $20,000, but a team of state employees submitting a suggestion may receive up to $100,000.

[29] California has used various approaches to promote its program, including putting information about the program on the flaps of state agencies' inter-office envelopes.

[30] David Ammons and William Rivenbark, "Gainsharing in Local Government," *Popular Government* (Spring/Summer 2006), 34.

[31] David Osborne and Peter Hutchinson, *The Price of Government: Getting the Results We Need in an Era of Permanent Fiscal Crisis* (New York: Basic Books, 2004), 179.

> This effect was not influenced by the location of the study (business, government, or school), the competitive structure of the incentive system (programs where only the highest performers get incentives versus programs where everyone who increased performance receives incentives), the type of study (whether the study was a laboratory experiment or a field study), or the performance outcome (quality, quantity, or both). In these studies, money was found to result in higher performance gains than non-monetary, tangible incentives (gifts, travel).[32]

We do not know whether the gainsharing program outlined in state law will, in fact, identify significant cost savings and prove feasible to implement. However, the Legislature has required MMB to develop a gainsharing program, and this concept has been implemented in other locations.

RECOMMENDATIONS

The Minnesota Department of Management and Budget should promptly formalize policies and procedures to implement the gainsharing program required by *Minnesota Statutes* 2017, 16A.90.

MMB has not established policies for the administration of the gainsharing program, and it told us it has no immediate intent to do so.[33] MMB's August 2017 progress report articulated possible criteria and procedures for reviewing gainsharing proposals, but the program cannot be implemented until MMB takes additional steps.

We recognize that there are many uncertainties that would affect implementation of a gainsharing program. For example, it is hard to predict how many employees will submit proposals for gainsharing awards, and how many of the proposals will meet minimum standards for cost documentation. But, while uncertainties remain, more than six years have passed since the original 2011 gainsharing legislation, and it is time for MMB to move forward. If problems arise during program administration, MMB can inform legislators in its twice-yearly gainsharing reports. MMB's prior reports to the Legislature did not suggest any specific changes to the gainsharing statute. MMB has indicated that it would need additional funding to implement gainsharing, but the 2017 Legislature considered this issue and did not make an appropriation for this purpose.

[32] Steven Condly, Richard Clark, and Harold Stolovitch, "The Effects of Incentives on Workplace Performance: A Meta-Analytic Review of Research Studies," *Performance Improvement Quarterly*, 16, n. 3 (2003), 46 and 58.

[33] According to MMB's August 2017 progress report, the "program development" phase of the gainsharing program was supposed to have been completed by the end of June 2017. The report projected no "program development" expenditures occurring in Fiscal Year 2018 or beyond.

The Legislature should clarify the relationship between the gainsharing law and other statutory provisions regarding employee compensation.

Minnesota Statutes 2017, Chapter 43A, addresses a wide range of topics related to state personnel management, including provisions related to collective bargaining. For example, the law says: "Except as provided in [*Minnesota Statutes* 2017,] section 43A.01, and to the extent they are covered by a collective bargaining agreement, the compensation, terms and conditions of employment for all employees represented by an exclusive representative certified pursuant to [*Minnesota Statutes* 2017] chapter 179A shall be governed solely by the collective bargaining agreement executed by the parties and approved by the legislature."[34] We asked staff with the Minnesota House of Representatives Research Department how the gainsharing statute interacts with the more general compensation provisions in the statutes. For example, we asked whether state employee bargaining units could decide not to participate in the gainsharing program, or could set maximum award amounts that are lower than those established in the gainsharing statute. The staff we talked with noted that the gainsharing statute does not directly address these issues, and they said that the relationship between the gainsharing statute and other statutes regarding state employee compensation is ambiguous.

We are aware of one State of Minnesota employee contract that mentions employee gainsharing programs. The Commissioner's Plan says that agencies may adopt plans for the administration of lump-sum payment programs—including gainsharing programs—for employees covered by that plan. That contract says: "All expenditures shall be in the form of lump sum payments of no more than two thousand dollars ($2,000) per individual per fiscal year and shall not be incurred as a continuing obligation."[35] Thus, the Commissioner's Plan sets a ceiling on gainsharing payments that is well below the ceiling established by the gainsharing statute ($50,000).

We think the Legislature should clarify whether the provisions of the gainsharing statute are intended to be independent of (1) other statutory provisions related to employee compensation and (2) collective bargaining agreements negotiated pursuant to *Minnesota Statutes* 2017, Chapter 43A.

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[34] *Minnesota Statutes* 2017, 43A.18, subd. 1.

[35] *Commissioner's Plan*, July 1, 2015 through June 30, 2017, p. 56. The provisions of this contract remain in effect because the Legislature has not yet approved new employee contracts for the current biennium.

OLA
OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA • James Nobles, Legislative Auditor

January 25, 2018

Members of the Legislative Audit Commission:

In the pages that follow, Commissioner Myron Frans of the Minnesota Department of Management and Budget (MMB) responds to our report on state employee gainsharing. At his request, we have also included two prior MMB reports on the subject.

I want to address Commissioner Frans' statement in his letter that our report goes beyond a compliance review and "advocates for a new and separate 'profit sharing' gainsharing program." This is simply not true. We concluded that the law requires MMB to implement a gainsharing program and it has not done so. Our report presents some evidence that contradicts the implementation concerns MMB has expressed in earlier reports. But, as our report says:

> We do not know whether the gainsharing program outlined in state law will, in fact, identify significant cost savings and prove feasible to implement. However, the Legislature has required MMB to develop a gainsharing program, and this concept has been implemented in other locations.

Our office does not take a position on the merits of gainsharing, but we think that gainsharing is both a plausible policy idea and one that MMB is required in law to implement.

Sincerely,

James Nobles
Legislative Auditor

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THE GREAT SEAL OF THE STATE OF MINNESOTA
L'ETOILE DU NORD
1858

January 22, 2018

James Nobles, Legislative Auditor
Office of the Legislative Auditor
Centennial Office Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

I have had an opportunity to review the report titled "*Special Review: Employee Gainsharing Program.*" I appreciate the opportunity to respond to your findings and correct the inaccuracies and erroneous legal conclusions contained in your report.

I am pleased that the Legislature has requested your office review the program outlined in Minn. Stat. § 16A.90. Minnesota Management and Budget (MMB) has, on numerous occasions, provided information to the Legislature on the efficacy of gainsharing programs, the significant problems with implementation and underfunding, and concerns over sufficient internal controls to prevent fraud and employee conflict. Unfortunately, the Legislature has not shown any consideration of these concerns. I hope that the Legislature will address the serious operational problems presented by the 2017 amendments to the statute and the lack of resources available to implement the program.

Your report fails to give proper credit to the previously provided comprehensive MMB reports to the Legislature in 2015 and 2017. Consequently, I have attached the reports as addendums to my response.

I will address your report's two findings in turn.

Audit Finding #1 – MMB Compliance with Statute Prior to 2017 Amendments

MMB complied with the statutory requirements of Minn. Stat. § 16A.90. Your report asserts that, prior to the 2017 amendments, MMB had not complied with the language of Minn. Stat. § 16A.90. This is a serious charge and it is incorrect.

In 2012, MMB implemented an employee performance-based achievement award program. This award program complies with the plain statutory language in effect prior to the 2017 amendments. Details of MMB's compliance are addressed comprehensively in MMB's 2015 report to the Legislature. The 2015 report analyzes serious concerns with the alternative "profit-sharing" approaches to gainsharing. After MMB provided the report to the Legislature in 2015, we received no further inquiries until the 2017 legislative session.

Achievement awards are presented to employees who, among other things, "reduce the costs of operating state government or for ways of providing better or more efficient state services." Minn. Stat. § 16A.90, subd. 1. MMB was required to establish a program under this section and did so. MMB did not implement the permissive option of a "profit-sharing" model under the statute and is well aware that some Members of the Legislature would have preferred this approach, despite our significant, continued, and well-documented concerns. As you are likely aware, when it comes to statutory compliance, the plain language of the statute controls, not the projected intent of any particular legislator. *See* Minn. Stat. § 645.16 ("Every law shall be construed, if possible, to give effect to all its provisions. When the words of a law in their application to an existing situation are clear and free from all ambiguity, the letter of the law shall not be disregarded under the pretext of pursuing the spirit."); *Rosenstiel v. Rodriguez*, 101 F.3d 1544, 1552 (8th Cir. 1996) (finding that "an isolated statement by an individual legislator is not a sufficient basis from which to infer the intent of that entire legislative body"); *see also Ninetieth Minnesota State Senate v. Dayton*, 903 N.W.2d 609, 617-618 (Minn. 2017) (upholding Governor's exercise of line-item veto where it complied with the explicit language of the Minnesota Constitution, and determining that court must follow plain language regardless of the wisdom of the provision or intent of the framers); *Rohmiller v. Hart*, 811 N.W.2d 585, 590-591 (Minn. 2012) (rejecting challenge that statute's silence created ambiguity, and stating "[w]e cannot add words or meaning to a statute that were intentionally or inadvertently omitted").

Your interpretation that MMB did not comply with the law prior to the 2017 amendments is incorrect. I am confident that a court would reject your legal conclusion in this finding.

Audit Finding #2 – MMB Implementation of 2017 Amended Statute

In 2017 MMB carefully researched and planned how to implement a new "profit sharing" program. As required by the revised statute, MMB submitted a report to the Legislature in August 2017. Through this process, MMB once again carefully examined the processes, procedures, and challenges around creating a new "profit sharing" program. Through our research, extensive problems with implementation, cost, and internal controls were analyzed and found to make a new "profit sharing" program unworkable. These issues were similar to those MMB reported to the Legislature in 2015. I will not repeat the numerous concerns of the 2015 and 2017 reports here as they have been clearly outlined in those documents, which are attached to this report.

To the extent that your report, under Audit Finding #2, goes beyond a statutory compliance review and advocates for a new and separate "profit sharing" gainsharing program, it does not do so responsibly nor thoroughly. While your report briefly mentions some of the concerns MMB has with a new "profit sharing" program, you have elected to also reference extremely limited – and out of date – scholarly research as support for implementation of a "profit-sharing" program. You also note that other states have adopted such programs. The articles referenced in your report are at least a decade old, written at a time when the exploration of these programs in the public sector was politically fashionable. Since that time, numerous states have either ended their "profit sharing" programs or allowed them to become defunct. Indeed, in the background section of your report, the history of gainsharing in Minnesota state government is briefly mentioned, including "profit sharing" programs at the

Department of Employee Relations in 1995 and the Metropolitan Council in 1998. Both programs were repealed within a few years of implementation, yet your report does not investigate why.

MMB has reviewed these programs as well as those in other states and found the risks and costs of a new “profit sharing” program across all of the executive branch are too high to ignore. We must learn from the mistakes of not only other states, but also from those in Minnesota when putting our resources and efforts toward employee programs.

As commissioner of MMB, I am not only the chief personnel officer for the state, I am also the state’s controller and chief accounting and financial officer. It is my statutory duty to look to results that create the most efficient and effective state services for Minnesotans and at the same time avoid fraud, abuse, and waste.

Again, I appreciate your interest in this topic. I am disappointed in your erroneous legal conclusions regarding MMB’s compliance, as well as your advocacy of a risky and costly new program.

Sincerely,

Myron Frans

Commissioner

MINNESOTA Management & Budget

July 15, 2015

The Honorable Sarah Anderson
Chair, House State Government Finance Committee
Minnesota House of Representatives
453 State Office Building
St. Paul, MN 55155

The Honorable Tom Saxhaug
Chair, State Department
and Veterans Budget Division
328 State Capitol
St. Paul, MN 55155

RE: Gainsharing: Report to the Legislature

Dear Representative Anderson and Senator Saxhaug:

In accordance with Minnesota Session Laws 2015, Chapter 77, Article 1, Section 13, the Commissioner of Minnesota Management and Budget (MMB) is required to report on the status of the gainsharing program required under Minnesota Statutes, Section 16A.90. The attached report is ordered to the House of Representatives State Government Finance Committee and the Senate State Departments and Veterans Budget Division and is due by July 15, 2015.

Further questions may be directed to John Pollard, Director of Legislative and Intergovernmental Affairs at john.pollard@state.mn.us or (651) 201-8039.

Sincerely,

Myron Frans

Myron Frans
Commissioner

Attachment

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GAINSHARING: REPORT TO LEGISLATURE

I. OVERVIEW

This report is being submitted in accordance with Minnesota Session Laws 2015, Chapter 77, Article 1, Section 13, requiring the Commissioner of Minnesota Management and Budget (MMB) to report on the status of the program required under Minnesota Statutes, Section 16A.90. The report is ordered to the House of Representatives State Government Finance Committee and the Senate State Departments and Veterans Budget Division and is due by July 15, 2015. Further questions may be directed to John Pollard, Director of Legislative and Intergovernmental Affairs.

II. STATUTE AND BACKGROUND

Initially enacted in 2011, Minnesota Statutes Section 16A.90 requires the Commissioner of MMB to establish an employee gainsharing system to provide bonus compensation to state employees for efforts made to reduce the cost of operating state government or to provide better or more efficient state services. As originally drafted, the program provided that employees involved may be authorized to receive a cash award of up to ten percent of the savings realized, but no more than $50,000.

In general, gainsharing is a system of management in which an organization seeks higher levels of performance or increased efficiencies through the involvement and participation of its people. The "gains" achieved through improved performance or increased savings are shared financially with the employee or group of employees according to a predetermined formula. The concept enables employees to participate in the improvement of government services and share in the rewards.

III. SHARING GAINS IN THE PUBLIC SECTOR

Gainsharing is similar to other profit sharing initiatives that have been used in the private sector to incentivize employees to increase productivity, create efficiencies, and save money for their organization. Public sector jurisdictions, including state governments, are beginning to explore budget and recognition practices that financially reward employees for their innovative ideas to lower government costs or improve service quality.

<u>**Programs in Other States**</u>

Alabama Employees' Suggestion Incentive Program: A State employee may submit a suggestion to reduce expenditures or increase efficiency within the State of Alabama. The program will make financial incentive awards to State employees whose adopted suggestions result in substantial financial savings or improvement in the efficiency of State operations. Employees may receive a one-time cash award of $1,000. In exceptional situations, the Board may award up to $5,000.

California Department of Human Resources Employee Suggestion Program: Formal system for rewarding employees who submit ideas that reduce or eliminate State expenditures or improve the safety or operation of State government. Awards range from $50 to $50,000.

Indiana State Personnel Department Employee Suggestion Programs: An opportunity for state employees to be recognized for their suggestions. Employees can earn cash and/or recognition for quality improving thoughts and cost saving ideas.

Illinois State Government Suggestion Award Board: Employees may submit ideas that will make government more efficient and effective. If the employee's suggestion results in financial savings to the state and taxpayers, the employee could receive an award ranging from $50 to $5,000.

Maine Employee Suggestion Awards Program: Designed to improve Maine State Government by identifying ways to improve operations, reduce or eliminate expenditures and improve morale. Employees may receive cost savings and/or efficiency awards for their suggestion.

New Hampshire State Employee Suggestion and Extraordinary Service Award Program: Recognizes state employees who perform a service in their jobs that goes above and beyond the call of duty or who make suggestions that raise revenue or save costs. The Legislature appropriates $10,000 in the governor's budget each fiscal year to provide such awards.

New York State Employee Suggestion Program: Accepts suggestions that are unusual or meritorious in nature and result in significant cost savings to the State's taxpayers and/or dramatically improve efficiency. Employees whose suggestions save a determinable amount of money may be eligible for a monetary award.

North Carolina Office of State Human Resources NC Thinks! Program: Rewards state employees for providing innovative solutions to pressing organizational challenges, paying cash incentives to state employees whose money-saving suggestions are approved.

North Dakota State Employee Suggestion Incentive Program: State employees may submit a recommendation or proposal to reduce expenditures within the employee's agency. If the recommendation or proposal is approved, the state employee is entitled to receive 20 percent of the first year's savings realized, up to a maximum of $4,000.

Tennessee Department of Human Resources Employee Suggestion Award Program: Provides a way for state employees to submit their good ideas and suggestions to improve state government operations or services and reduce costs. Cash awards are available for adopted and approved suggestions up to $10,000.

Washington Secretary of State Productivity Board Employee Suggestion Program: Provides cash incentives and recognition for state employees who submit suggestions to save the state money, generate revenue, and/or improve services or processes within state government. Cash award may equal 10% of the first year net savings (maximum $10,000).

West Virginia Employee Suggestion Program: Created to stimulate creative and innovative thinking, and reward State workers who suggest cost-saving ideas. Monetary awards of up to 20% of the first year's savings (up to a maximum of $10,000) are possible.

Wisconsin Employee Suggestion Program: The Employee Suggestion Board has three members appointed to evaluate employee suggestions that improve the quality of state government operations and services. Employees recognized for saving money may be eligible for a cash award.

Florida: Florida's Innovation Funds lend state agencies money to front expenses associated with a new practice or technology. Agencies are then expected to use their savings to repay the interest-free loan.

Georgia and California: These two states have devised programs to allow agencies to retain a percentage of savings from innovation. Georgia's program rewards innovation that yields ongoing savings for the State. If the cost savings accumulate over a number of years, agencies may keep a portion of what is saved each year.

Mississippi: The state finance director identifies programs with innovative actions that merit reward. The finance director then makes a recommendation to the Legislature of an award amount and how the agency will be allowed to apply the award.

Texas: The state of Texas provides financial rewards to agencies that meet or exceed specific performance expectations. The rewards may take the form of increased transfer authority, contract authority, appropriations, or may involve a bonus for key staff.

Massachusetts and Oklahoma: These two states have developed programs that allow agencies to carry forward funds saved through efficiency into the next fiscal year.

Source: National Conference of State Legislatures, *Fundamentals of Sound State Budgeting Practices*.

IV. SHARING GAINS IN THE STATE OF MINNESOTA

Achievement Awards

The State of Minnesota executive branch agencies have approached gainsharing through Achievement Awards. Achievement Awards are monetary awards granted throughout the State to recognize outstanding employee achievement and can be used in situations where financial savings have been achieved. Achievement awards may be granted for team recognition, project recognition, and individual recognition. MMB sets the foundation for Achievement Awards in statewide Human Resource/Labor Relations Policy #1420, but each state agency granting Achievement Awards must develop their own policy, including agency-specific criteria, processes and requirements. Notably, the MMB Employee Recognition and Achievement Award Policy and Procedures promote achievement awards as an essential element for creating and maintaining a culture that recognizes innovation and creativity, reduces waste, creates cost savings, makes government work better, and recognizes the outstanding work of State employees.

The funding for Achievement Awards is included in an agency's annual operating budget. They are typically granted in the form of a lump-sum payment, unless a collective bargaining agreement allows otherwise. Achievement Awards may be granted quarterly, or as frequently as practical for an agency. Employees are nominated for Achievement Awards by their co-workers or managers/supervisors, and each award must be approved by the recipient's manager/supervisor.

Collective bargaining agreements and compensation plans place limits on the number/value of Achievement Awards that employees may receive each fiscal year. For example, under the current MAPE contract, employees are limited to one Achievement Award per fiscal year, not to exceed $1,000. The MAPE agreement limits the number of employees who can receive an Achievement Award to no more than 35% of those authorized at the start of the fiscal year. These limits may vary by collective bargaining agreement or compensation plan.

In Fiscal Year 2014, the state rewarded employees with a total of 2,659 individual and team achievement awards valued at over $2.7 million. See the chart below for an agency-specific breakdown.

Executive Branch Agency Fiscal Year 2014 Achievement Award Activity

Department	Total # of Awards	Aggregate $ Value of Awards
Agriculture	11	$10,500
Animal Health Board	7	$9,100
Barber Examiners Board	1	$2,000
Behavioral Health & Therapy Board	2	$3,000
Bureau of Mediation Services	6	$7,500
Campaign Finance & Public Discl Bd	1	$1,000
Capitol Area Architect	1	$1,200
Commerce Dept.	64	$27,850
Cosmetologist Exam Board	3	$4,600
Court Of Appeals	15	$3,650
Dentistry Board	10	$7,600
Department of Human Services	610	$686,500
Dietetics & Nutrition Practice	1	$2,000
Disability Council	2	$1,000
Education Department	37	$31,800
Emergency Medical Services Bd	6	$3,500
Employ & Econ Development Dept	74	$69,400
Explore Minnesota Tourism	9	$9,100
Health Department	56	$62,500
Higher Ed Facilities Authority	2	$2,000
Housing Finance Agency	89	$72,945
Investment Board	5	$2,250
Labor & Industry Dept	21	$24,400
Legislative Auditor	7	$6,000
Medical Practice Board	4	$6,600
Minnesota Zoological Garden	12	$20,400
Mn Management & Budget	59	$40,075

MN St Colleges & Universities	340	$386,758
MN State Retirement System	37	$32,733
MN.IT Services	116	$65,500
Natural Resources Dept	33	$14.600
Nursing Board	7	$4,500
Nursing Home Admin Board	1	$2,000
Office of Higher Education	10	$10,000
Optometry Board	1	$2,000
Perpich Ctr For Arts Education	1	$2,000
Pharmacy Board	5	$7,500
Physical Therapy Board	1	$2,000
Podiatric Medicine Board	1	$2,000
Pollution Control Agency	55	$42,300
Psychology Board	4	$4,600
Public Employees Retire Assoc	2	$2,334
Public Safety Dept	29	$15,000
Revenue Dept	138	$103,075
Social Work Board	4	$4,600
Teachers Retirement Assoc	28	$27,733
Transportation Dept	653	$895,250
Trial Courts	67	$47,100
Veterinary Medicine Board	1	$2,000
Water & Soil Resources Board	10	$8,300
Totals	2,659	$2,787,768

Employee Recognition

In addition to granting Achievement Awards, state agencies have developed other monetary and non-monetary employee recognition practices specifically aimed at encouraging innovative cost savings and increasing productivity.

Office of Enterprise Technology (MN.IT Services) Living the Mission Recognition Award: A peer-to-peer recognition program to recognize and reward outstanding work of employees that reinforces MN.IT's stated values, including: Can-do!; Respect; Work Smart (efficiency, productivity, cost savings); or Practice Leadership.

Iron Range Resources & Rehabilitation Board Above & Beyond Employee Recognition Program: Recognizes employees who exhibit excellence in a variety of areas, emphasizing contributions and accomplishments on the job which represent dedication, innovation, creativity, cooperation and excellent customer service.

Minnesota Lottery Employee Recognition Program: Quarterly recognition of individuals and groups for excellence in fulfilling the Lottery's mission. Employees nominate other employees for achievements in the following categories: Money-saving process; Work productivity; Quality and effort; Customer service; Time-saving process; or other. The program also recognizes employees on a quarterly basis for the best new employee idea or concept.

Department of Natural Resources Commissioner's Awards: Designed to recognize the exceptional accomplishments of DNR staff, focusing on achievements that reflect DNR's mission and values in the following areas: Conservation Enhancement; Customer Assistance; Behind the Scenes; Leadership; and Innovation.

Minnesota Pollution Control Agency Staff Voyageur Award: Recognizes staff excellence in five categories that reflect agency values and support agency mission: Teamwork; Environmental Improvement; Leadership; Customer Assistance/Service; Keeping the Ship Afloat. Additionally, the Gordie Memorial Award is presented in honor of former employee Gordie Wegwart, recognizing and thanking individual staff or teams whose continuous improvement or innovation efforts have made a difference in the effectiveness of MPCA.

Minnesota Department of Revenue Division Recognition Award Programs: Encourages divisions to recognize employees for significant accomplishments, such as agency cost savings, efficiency ideas, savings to the division, change in the way business process is completed, or customer satisfaction increase.

Department of Transportation We Are MnDOT Recognition: Co-workers nominate employees who amaze, astound and impress in the following categories: Demonstrating adaptability; Expressing care and appreciation; Maintaining integrity; Creating accountability; Building community; Modeling trust; Exhibiting phenomenal communication; or Instituting quality and innovation.

<u>Continuous Improvement Initiatives</u>

Minnesota Office of Continuous Improvement: A division of the Department of Administration with the mission to improve Minnesota government every day by leading and supporting government agencies as they build continuous improvement (CI) into their organizational culture and day-to-day business practices. The office empowers employees and improves organizational performance through use of time-tested CI tools and methodologies, including Lean, Six Sigma, Total Quality Management, and more.

Documented CI success stories throughout the state include: An estimated annual savings of $255,000 and 5,000 staff hours at the DNR as a result of new web-based improvements to the process of obtaining water permits; An estimated 60+ percent reduction in the time it takes the Department of Labor and Industry to issue licenses for individuals and contractors seeking construction licenses; An annual savings of $16,000 at the Minnesota Housing Finance Agency as a result of improvements in distributing Housing Assistance Payment Vouchers; and an estimated annual savings of $960,000 at the Department of Human Services due to efficiencies that reduced staff time for personal care attendant appeals.

In addition, the Office of Continuous Improvement partners with the Governor to present the Governor's Continuous Improvement Awards annually. These awards recognize significant individual and organizational achievements from across Minnesota government that have increased the efficiency, quality and value of State government services.

Better Government Initiatives

Better Government for a Better Minnesota: A series of initiatives to support Governor Dayton's efforts to cultivate change throughout the state by saving money, reducing waste, and making government work better for the people of Minnesota. These efforts are aimed at changing the way we do business in Minnesota by updating systems, reforming programs, and eliminating bureaucratic layers of process that no longer work.

Current Program Improvements and Reform:

- Buy health not sickness: Reform how Minnesota delivers and pays for health care.
- Develop a business plan to grow Minnesota jobs and competitiveness.
- Make Minnesota's tax system more fair and put Minnesota's fiscal house in order.
- Deliver better schools for a better Minnesota.
- Health Aging: Connect Minnesota seniors with services and their community.
- Infrastructure: Build the roads, bridges, broadband network and other connections that create jobs.

Current System Improvements and Reform:

- Regulatory Reform: Streamline business permitting and licensing
- LEAN: Continuously improve business processes
- Performance improvement: Reward performance and results
- Technology: Improve how technology works for state government and our citizens
- Sustainability: Reduce state energy consumption, waste, and greenhouse gas emissions.
- Improve how state government buys stuff and manages its assets.

State Agency Value Initiative (SAVI)

In 2011, the Minnesota Legislature established the State Agency Value Initiative (SAVI) under M.S. 15.76. This program may allow agencies to retain up to 50% of unspent appropriations resulting from unanticipated innovation, efficiencies and creative cost savings. The agencies may use these funds on one-time items or short-term initiatives to support the performance of the agency's mission.

The legislation became effective on June 30, 2013 and MMB has developed and implemented a process for review of SAVI-eligible appropriations carryover requests. As of June 2015, one SAVI request has been received, submitted by the Department of Administration. The single submission was for money saved due to activities conducted by the Office of Continuous Improvement. The Department of Administration reinvested these funds in its continuous improvement division.

V. CHALLENGES WITH GAINSHARING

Measuring gains is at times an imperfect exercise that could lead to inequitable results and rewards or, at the very least, could open the door to unnecessary employee disputes or appeals of rewards in which the employee feels entitled to a greater share of the gain. Programs within the state agencies vary greatly in terms of size, scope, structure, purpose and performance measurements. A uniform method to document savings across dissimilar programs is challenging.

The statute states that if an employee's job is to explicitly find efficiencies within state programs, the statute exempts the employee from the program. Sound fiscal management, however, generally assumes that it is every employee's responsibility to explore and develop efficiencies within the state program where they are employed.

Legal or budget constraints limit the state's ability to use savings for gainsharing. Funds provided by another level of government or an external source must often be used for a specific purpose. For example, the state's use of federal funds is governed by cooperative and grant agreements, and any plan to change the use of these funds, or to retain savings for another purpose, is subject to federal review and approval. The same kind of constraint may apply to transfers between funds within a jurisdiction. For example, if savings are generated in a fund that receives transfers from another fund, any savings may need to be returned to the originating fund to comply with appropriations law.

The terms of collective bargaining agreements and compensation plans enable the employer to grant Achievement Awards to certain represented employees. Employees represented by AFSCME are generally ineligible to receive achievement awards because the AFSCME contract does not authorize them.

It is important to note that the State of Minnesota currently provides monetary and non-monetary recognition to those employees who go above and beyond to deliver outstanding results in the workplace. These rewards and awards encourage exceptional employee performance. Monetary awards are generally capped at a range from $1,000 to $2,000 under the applicable collective bargaining agreement or compensation plan, which is an amount sufficient to provide adequate recognition for those who go beyond their day-to-day performance requirements and motivate others to do the same, without the likelihood of causing significant concerns to taxpayers.

While state employees appreciate recognition of the good work they do this appreciation need not be in the exclusive form of bonus compensation. In fact, social science studies repeatedly conclude that for all but simple and routine tasks, financial rewards designed to motivate performance actually have the opposite effect. Public recognition by the legislature and/or the public for good work, for example, would be a welcome, motivating and appreciated form of employee acknowledgement.

MANAGEMENT AND BUDGET

State Employee Gainsharing

Report to the Legislature

August 1, 2017

As required by M.S. 16A.90

Table of Contents

Introduction

Gainsharing began as a profit-sharing initiative in the private sector designed to incentivize employees to increase productivity, create efficiencies, and save money for an organization. Under a gainsharing program in a private enterprise, an employee is awarded a share of the increased profits that the employee's idea created. Several states have attempted to implement a similar concept by providing state employees a bonus award for ideas that save the state money. For the purpose of this report, gainsharing and employee recognition programs in other states have been examined. There are at least 14 other states that implement programs for rewarding employee suggestions with financial incentives. Cash incentives are often just one component of wider employee recognition programs. The state programs vary widely in their terms, application, and outcomes.

A previous report on state employee gainsharing in Minnesota was completed in 2015 and is included as an addendum to this report. The report outlines that the state has been implementing a variety of employee award and recognition programs, including Achievement Awards that incentivize efficiency, creativity, and hard work by state employees. Achievement Awards are monetary awards granted throughout the state to recognize outstanding employee achievement, including circumstances where financial savings to the state have been realized. However, in 2017 Minnesota Statute 16A.90, authorizing a gainsharing program, was amended to require a separate program from these current employee recognition programs. Several concerns about a separate gainsharing program were listed in the 2015 report that remain considerations today.

Below is the statute that authorizes a gainsharing program for Minnesota Executive Branch employees with the new 2017 language underlined.

> **16A.90 EMPLOYEE GAINSHARING SYSTEM.**
>
> Subdivision 1. Commissioner must establish program.
>
> > (a) The commissioner shall establish a program to provide onetime bonus compensation to state employees for efforts made to reduce the costs of operating state government or for ways of providing better or more efficient state services. The commissioner may authorize an executive branch appointing authority to make a onetime award to an employee or group of employees whose suggestion or involvement in a project is determined by the commissioner to have resulted in documented cost-savings to the state. Before authorizing awards under this section, the commissioner shall establish guidelines for the program including but not limited to:
> >
> > > (1) the maximum award is ten percent of the documented savings in the first fiscal year in which the savings are realized up to $50,000;
> > >
> > > (2) the award must be paid from the appropriation to which the savings accrued; and
> > >
> > > (3) employees whose primary job responsibility is to identify cost savings or ways of providing better or more efficient state services are generally not eligible for bonus compensation under this section except in extraordinary circumstances as defined by the commissioner.

(b) The program required by this section must be in addition to any existing monetary or nonmonetary performance-based recognition programs for state employees, including achievement awards, continuous improvement awards, and general employee recognitions.

The statute requires a report be submitted to the legislature twice a year, beginning on the date of enactment of the updated statute, August 1, 2017. Below is the statutory language outlining the requirements of this report.

Subd. 2. **Biannual legislative report.** No later than August 1, 2017, and biannually thereafter, the commissioner must report to the chairs and ranking minority members of the house of representatives and senate committees with jurisdiction over Minnesota Management and Budget on the status of the program required by this section. The report must detail:

(1) the specific program guidelines established by the commissioner as required by subdivision 1, if the guidelines have not been described in a previous report;

(2) any proposed modifications to the established guidelines under consideration by the commissioner, including the reason for the proposed modifications;

(3) the methods used by the commissioner to promote the program to state employees, if the methods have not been described in a previous report;

(4) a summary of the results of the program that includes the following, categorized by agency:

(i) the number of state employees whose suggestions or involvement in a project were considered for possible bonus compensation, and a description of each suggestion or project that was considered;

(ii) the total amount of bonus compensation actually awarded, itemized by each suggestion or project that resulted in an award and the amount awarded for that suggestion or project; and

(iii) the total amount of documented cost-savings that accrued to the agency as a result of each suggestion or project for which bonus compensation was granted; and

(5) any recommendations for legislation that, in the judgment of the commissioner, would improve the effectiveness of the bonus compensation program established by this section or which would otherwise increase opportunities for state employees to actively participate in the development and implementation of strategies for reducing the costs of operating state government or for providing better or more efficient state services.

The gainsharing program proposed in this report is the most streamlined and efficient process that Minnesota Management and Budget (MMB) has developed by the reporting date. However, numerous significant concerns remain. The final two sections of the report address considerations of funding and potential problems with implementation.

Considerations of Internal Controls

Because a new gainsharing program is in the developmental stage, this report includes proposed guidelines for a program as well as summaries of the requirements associated with development and implementation. The inclusion of information on the potential risks and concerns are critical to any discussion on a gainsharing program because the Commissioner of MMB must effectuate implementation in a manner that provides reasonable assurances that the objectives of the program are accomplished balanced with core internal control responsibilities created by law.

The commissioner is, by statute,[1] responsible for the coordination, design, implementation, and maintenance of an effective system of internal controls for all executive branch agencies. The commissioner is also under an obligation to safeguard public funds and assets to minimize incidences of fraud, waste, and abuse. In executing these responsibilities, the commissioner fulfills another statutory obligation to ensure that programs are administered in compliance with federal and state laws and rules. This compliance requires written and clear documentation of internal control procedures over financial management activities, the analysis of risks, and periodic evaluation of control procedures to make sure they are properly designed, implemented, and functioning. The obligation would be the same for the development and implementation of any state program.

The evaluation of any new program that impacts the entire Executive Branch workforce must be comprehensive. Executive Branch agencies represent approximately 35,319 employees in 78 agencies. If Minnesota State Colleges and Universities (Minnesota State) employees are determined to also be eligible, that number expands to 49,889. Subsequently, implementation of the program must be carefully considered to allow for a fair and effective process for all employees of the enterprise to engage.

The State's internal control standards, as adopted from the Standards for Internal Control in the Federal Government or the "Green Book," provide a framework that easily guides evaluation of the development and implementation of a new entity or program. In a new program driven by statute, this is especially true because often the law includes language on what the Green Book considers the three core categories for all program objectives: operations, reporting, and compliance.

Operational objectives focus on "how" things are achieved and include areas such as human resources, production, financial management, information technology, policies, and procedures. They also relate to the effectiveness and efficiency of program operations to achieve the overall mission. For a gainsharing program, this requires the evaluation of staffing of the program and related human resource matters (recruitment, hiring, training, and related personnel matters). Similarly, development and implementation of a gainsharing program requires the consideration of matters related to production. Here, production might include how the gainsharing program operates, such as workflow, document management, and policies and procedures. The financial aspect of a gainsharing program is another operational objective that is both critical and complicated. The evaluation of financial objectives includes issues related to an appropriation to develop and implement the program, the workflow for related financial transactions, and the necessary control activities. Additionally, any program of the State that involves money will require consideration of requisite policies and procedures and information

[1] Minn. Stat. 16A.057, subd. 1(1)-(3).

technology. For gainsharing, at a minimum SWIFT and related financial systems are impacted to ensure appropriate fiscal management and oversight.

Reporting objectives relate to the preparation of reports for use by the program, its stakeholders, or other external parties[2]. The employee gainsharing program statute is clear on the program's reporting objectives and requires a biannual report from the commissioner to the chairs and ranking minority members of the House of Representatives and Senate committees with jurisdiction over MMB on the status of the program.[3] The statute is specific about what is to be included in the report. A comprehensive evaluation considering the development and implementation of this program, includes reporting objectives and any associated issues. For the gainsharing program, that might include the staff and preparation efforts necessary to develop the report as well as the efforts across the State and their obligation to generate data responsive to the report requirements.

Compliance objectives relate to compliance with applicable laws and regulations and are significant. In addition to ensuring compliance with the authorizing statute, Minnesota Statutes, Section 16A.90, the State as a government faces a complex system of both state and federal law, related regulations, and governing policy and procedure. Specifically, legal obligations related to federal funds provided to the State are likely to cause complications or issues for any gainsharing program. The existence of the collective bargaining agreements will also influence implementation of any gainsharing program.

Considering the operational, reporting, and compliance objectives of the proposed employee gainsharing program requires consideration of the necessary internal controls. There is a direct relationship between a program's objectives and the five components of internal control: control environment, risk assessment, control activities, information and communication, and monitoring. The objectives are what the program is intended to achieve. The five components of internal control are what is required to achieve the objectives.

In order to develop and implement a gainsharing program that will achieve the intended objectives, it should be developed using a sound system of internal control. The nature of the gainsharing program makes this even more critical given the State's obligation to be prudent stewards of public funds. This includes the commissioner's obligation to oversee the internal control system of the Executive Branch by giving attention to the control environment, risk assessment, control activities, information and communication, and monitoring.

The last two sections of this report addresses challenges identified in the development and implementation using the framework described above.

Proposed Gainsharing Program Guidelines

The framework for a Minnesota Employee Gainsharing Program requires an examination of employee eligibility, suggestion eligibility, a process for evaluation of suggestions at the agency level and at Minnesota Management and Budget, and a determination on how to budget for documented savings that occur in the first fiscal year that an implemented idea realizes savings. The following is an outline of considerations that must be addressed

[2] GAO-14-704G, Federal Internal Control Standards (Green Book), OV2.21. (Overview)
[3] Minn. Stat. 16A.90, Subd. 2.

by program guidelines and criteria. These considerations are based on Minnesota-specific factors (e.g., statute) and research on practices of other states that have gainsharing (or similar) programs.

Eligibility

In order to implement a gainsharing program, specific eligibility criteria must be fair and unambiguous. Below are suggestions in the process of determining the eligibility of employees and their ideas for providing better or more efficient state services.

Eligible Employees

A determination must be made regarding which definition of "executive branch" governs employee participation in the program. At this stage of research, it is believed that executive branch employees, including those at Minnesota State, may participate.

Ineligible Employees

A determination must be made regarding whether some roles or employee statuses must be excluded from program participation. In this consideration, it is important to note the challenge of excluding only certain categories of employees when it is the mission of all state government agencies and the job of all employees to save state resources and perform work efficiently.

Examples of employee roles or statuses that should be specifically ineligible include:

- Commissioners and Deputy Commissioners.
- Employees principally involved in process improvement, reengineering, etc.
- Employees on layoff, leave of absence, retired, resigned, etc.
- Employees in a probationary period, pre-probationary, or trainee appointment.
- Employees performing duties in support of the administration of the Gainsharing Program at any Executive Branch agency.
- Employees who are not in active status both at the time the suggestion was submitted and at the time the award has been approved.
- Employees who do not have a current satisfactory or better performance review on file in the Human Resources Office.

Eligible Gainsharing Suggestions

The scope of eligible ideas must:

- Provide better or more efficient state services and reduce the costs of operating state government.
- Result in documented cost-savings to the state that can be realized in the first fiscal year[4].

[4] Minn. Stat. 16A.90 outlines that onetime bonus compensation be awarded "to state employees for efforts made to reduce the costs of operating state government *or for ways of providing better or more efficient state services*." (emphasis added). The statute also requires that the effort result in "documented cost-savings to the

Ineligible Suggestions for Gainsharing Awards

A determination must be made regarding what types of suggestions are ineligible. If a suggestion improves the efficiency or effectiveness of state services but results in no documented cost savings, the suggestion would not be eligible for a gainsharing award. However, it is possible that the idea may be considered for an employee Achievement Award[5].

Research from other state gainsharing programs indicate that ineligible ideas include suggestions that:

- Rely on changes to law, collective bargaining agreements, or compensation plans.
- Alter or create new taxes or fees.
- Recommend a change in job class or pay, or establishment of new positions (determining the basis for such decisions is the assigned role of Human Resource staff)
- Recommend a study or survey or other activity where any action taken is dependent on the findings.
- Have been previously implemented by one or more state agencies.
- Suggest changes to a program that is not supported by state funds.
- Propose making minor changes, for example, to databases; i.e., adding or deleting fields or creating or changing a data report.
- Will decrease the quality of a service provided by the agency or another government entity.
- Will shift costs to another entity.

Process for Submitting and Reviewing Ideas

States with employee suggestion programs have developed and established multi-level processes for reviewing and evaluating employee suggestions and making awards. These processes often involve employees who are responsible for administering or coordinating the program. A board or committee is also often used to evaluate the awards. The details vary from state to state, but what is clear is that states that have this type of program create and develop a process, which involves multiple people, across departments and agencies, and multi-level processes to ensure transparency, accuracy, and accountability.

Submission of Ideas

An Employee Gainsharing Form must be developed to capture the documentation needed to inform decision-making at the agency and MMB levels. At a minimum, the documentation must include:

- A description of the specific problem and provide a workable solution in as much detail as possible and include examples or attachments to validate the idea.
- The names and signatures of all employees who participated in development of the suggestion.
- The identity of each state agency and/or department affected by the suggestion.
- The employee(s) signature and date of form submission.

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state. Subsequently, those efforts that provide better or more efficient services, but result in savings that cannot be documented will not be eligible for a gainsharing award.

[5] Achievement Awards must confirm to limits contained in collective bargaining agreements, compensation plans, and MMB HR/LR Policy 1420 Employee Recognition and Achievement Awards.

The completed form would be submitted to the employee's Gainsharing Program Administrator within each individual agency.

Role of Agency Gainsharing Program Administrator

Each agency would assign primary support of the Gainsharing Program to an agency Gainsharing Program Administrator. At the idea submission stage, the Program Administrator, at a minimum would:

- Confirm each employee(s) eligibility to participate in the program.
- Conduct an initial review to determine whether the suggestion merits additional review.
- Notify employees whose suggestions have been declined of the basis of the denial.

Role of Agency Gainsharing Suggestion Review Team

Ideas that merit additional review would require additional resources to investigate the idea's merit and viability. Therefore each agency would need to find resources to staff a Gainsharing Suggestion Review Team.

It is estimated that the Gainsharing Suggestion Review Team would include several members, including but not limited to:

The receiving agency's financial or budget expert.

- The agency supervisor(s) or manager(s) of affected program(s).
- Management representation from other agencies whose programs would be affected by the idea.
- The MMB Executive Budget Officer assigned to the agency(ies) affected.

The scope of the Gainsharing Suggestion Review Team's work would, at a minimum, include:

- Review the suggestion.
- Conducting research, analyzing the problem, and determining the feasibility of implementing the suggestion.
- Consult with other departments or agencies affected by the suggestion. Each affected agency must be consulted and approve the suggestion before it could be implemented.
- Determine the degree to which any projected cost savings can be documented.
- Prepare a Gainsharing Suggestion Recommendation form and submit it to the agency's Commissioner or designee for a decision.
- If an employee(s) suggestion is approved, the agency's Gainsharing Program Administrator will ensure that each employee who signed the suggestion form receives notice of the approval of their suggestion.

At a minimum, as a result of the Agency Review Team's work the affected agency(ies) must:

- Document a summary of the results of the agency Gainsharing Program, including:
    - The total number of agency employees whose Gainsharing suggestions or involvement in a Gainsharing project were considered for a possible award.
    - A description of each Gainsharing suggestion or project that was considered.
    - The total amount of Gainsharing award compensation actually awarded, itemized by each suggestion or project that resulted in an award, and the amount actually awarded for that suggestion or project.

    - The total amount of documented cost-savings that accrued to the agency as a result of each suggestion or project for which an award was granted.
- Determine which implemented suggestions merit sending an Employee Gainsharing Form for approval of a Gainsharing Award Recommendation to MMB.
- Submit a Employee Gainsharing Form to the MMB Enterprise Gainsharing Program Administer when the facts support such action. The information to be submitted to MMB should include:
    - A description of the proposed cost-savings measure.
    - Information on whether the cost-savings measure impacts federal funding sources.
    - Information on whether the cost-savings measure likely impacts multiple state agencies.
    - Data on whether the measure will result in lower spending on material resources or services currently purchased by the agency. If so, 3 years of past, baseline data should be provided that summarizes recent spending patterns and the savings that would be delivered should be included with the proposal.
    - Data on whether the measure will result in lower spending on personnel costs in the form of reduced hours or headcount. If so, 3 years of past, baseline data should be provided that summarizes recent spending patterns and the savings that would be delivered with the proposal.
    - Information on whether there are other costs that will be saved aside from material, purchased services or labor. If so, 3 years of past, baseline data should be provided that summarizes recent spending patterns and the savings that would be delivered with the proposal.
    - Information on whether the measure requires an initial investment of funds by your agency. If so, an itemized list of staff (hours and wage rates) and material resources should be included.
    - Data on whether the measure may result in increased revenue to the agency. If so, 3 years of past, baseline data should be provided that summarizes recent revenue patterns and how the proposal will increase revenues.
    - Data on whether the cost-saving measure will result in a one-time benefit to the state or whether the cost reductions are expected to be realized over the course of several years. Expected annual cost savings must be documented.
- Upon successfully implementing the suggestion, the savings must be documented in the first fiscal year in which the savings are realized.[6]

Review and Approval by the Commissioner of Minnesota Management and Budget

Minnesota Management and Budget (MMB) must have the resources to staff the MMB Enterprise Gainsharing Program. Among these resources will be an Enterprise-Wide Gainsharing Program Administrator and an Enterprise Gainsharing Committee. Upon receipt of an agency-approved Employee Gainsharing Form, the Enterprise-Wide Gainsharing Program Administrator will:

- Document the receipt of each agency gainsharing award request.
- Confirm the successful implementation and documented savings with the affected agency(s).

[6] See section titled Process for Determining Savings.

- Confirm the documented savings and the amount of the monetary award for which each employee participant is eligible.[7] [8]
- Submit award recommendations to the MMB Commissioner or designee for consideration.
- Gather additional data requested to inform award decision-making.
- Communicate outcomes (approvals/denials) to requesting agencies and respond to questions.
- Document all outcomes of agency award requests.
- Assist in the coordination of enterprise-wide promotion of the program.

The Enterprise Gainsharing Committee is anticipated to be composed of MMB enterprise human resource staff, statewide budget officers, enterprise communications personnel, and executive branch leadership [Deputy / Commissioner level/ Director of Internal Controls]. Other agency representation and participation on this committee may add value and needed insights to the process of evaluation.

The Enterprise Gainsharing Committee would be responsible for developing and implementing the necessary enterprise-wide policies and procedures. This new program would incorporate applicable best practices of other states' gainsharing programs such as a suggestion process, training in the implementation of the program, multi-level review to verify eligibility and merit, approval of awards at the agency and enterprise level, and processes to facilitate reporting.

Proposed Methods to Promote Gainsharing Program

To ensure employee participation in the gainsharing program, executive branch agencies must develop strategies to communicate the parameters of the program and process to submit ideas to their employees. These methods may include the following:

- Provide detailed instructions on the program to all commissioners, deputies, managers, and human resource agency staff to ensure informed answers are provided to employees.
- Include stories in agency newsletters on the program as well as successfully implemented gainsharing ideas.
- Develop a link on state agency websites and the MMB website that provides information on the program.
- Develop a link on the state employee intranet page that provides an application form and detailed instructions.
- Suggest that all executive branch agency department heads explain the program during staff meetings.
- Include information on the program in employee hiring materials.

[7] An appeals process may be required for employees to challenge decisions on the amount of the award.
[8] The level of confirmation is not yet determined. An audit may be required.

Process for Determining Savings

Integral in a new gainsharing program is determining an effective and accurate way to budget savings within the confines of statute. This process presents several concerns that are listed in the final section of this report. Below is a general framework to follow in establishing a process for documenting savings.

Initial Documentation of Net Savings by State Agency

Each executive branch agency must identify a fiscal lead for the purposes of the employee gainsharing program. This individual will determine whether it is possible to document the fiscal impact associated with the project described in each proposal received by the agency. If the fiscal lead determines that it is not possible to document the fiscal impact, the proposal is not eligible for an award under the employee gainsharing program. Agency fiscal leads will use guidance along the following lines to calculate savings:

- **Cumulative net savings.** Savings should reflect the cumulative net savings of the project, after accounting for all costs associated with implementing the project.
- **Savings from first fiscal year.** As required by Minn. Stat. 16A.90 Subdivision 1(a)(1), the documented savings may only include savings from the first fiscal year in which cumulative net savings are realized. According to the statute, if a fraction of the overall savings are realized in the first year, the award is calculated from the savings of that fiscal year only.
- **Baseline for comparison.** The baseline for comparison shall be a scenario in which the identified project was not implemented. For example, the savings for a project to replace traditional light bulbs with energy efficient bulbs should reflect net savings compared to a scenario of continued use of traditional light bulbs. This may produce a different estimate than would be produced by using previous spending as the baseline. For example, assume all relevant costs in the prior year were $400,000, all relevant costs in the current year would have been $380,000 (due to lower electricity rates and reduced usage) and all relevant costs with the implementation of the project were $370,000. In this example, the net savings for purpose of the employee gainsharing system is $10,000 (i.e., $380,000 minus $370,000). If these savings are validated and the award is approved, up to 10% of the savings (i.e., $1,000) could be issued in the form of a gainsharing award.[9]
- **Coordinating across agencies.** For proposals that involve costs or benefits experienced by multiple agencies, the fiscal leads for each affected agency will coordinate to document the net savings. These determinations must then be confirmed by the Enterprise Gainsharing Committee and the MMB budget staff.

[9] The example of upgrading light bulbs was used to provide clarity into the budgeting process; however, this example would likely be ineligible for a gainsharing award because it is the job of every agency to routinely find these energy inefficiencies. Additionally, the vast majority of the savings for this idea would occur in future years with minimal documented savings realized the first fiscal year. An illustrative and accurate example could not be determined prior to the deadline of this report.

- **Use of savings.** As part of this process, the fiscal lead(s) will determine how the savings were used. If the savings were reinvested, the submission of the proposal to the agency head(s) and MMB shall describe the activities that were conducted and the results associated with the reinvestment.[10]

Considerations in Determining Savings

Below are important considerations associated with determining savings:

- **Establishing a baseline to compare against**: Determining cost savings involves comparing costs and benefits as they actually occurred to those costs and benefits that would have occurred in the absence of a given project. In some cases, this may be a relatively straightforward exercise that involves using data that is collected by existing systems. In other cases, it will be too difficult to disentangle the impact of the relevant project from the impact of other projects and external factors and/or adequate data will not be available.

- **Authority to pay awards from specific appropriations**: As required by Minn. Stat. 16A.90 Subdivision 1(a)(2), awards must be paid from the appropriation to which the savings accrued. For some appropriations, paying such awards would not be an authorized expense. We will only pay out awards where legally authorized.

- **Impact on multiple appropriations:** Some projects involve benefits and costs for multiple appropriations. In some cases, costs accrue to one appropriation and the resulting savings accrue to a different appropriation. In these cases, the documented savings that are paid out as awards will not exceed ten percent of the *net* savings.

Cost of Implementation

Implementing and administrating a new gainsharing program will require FTE hours amounting to approximately $1.6 million in statewide resources each year once the program is fully operational. This amount is based on the fiscal note for S.F. 605. Upon further analysis of the implantation of a new gainsharing program, this previous estimate is low and additional resources would be necessary. The cost reflected below primarily equates to lost productivity among employees at all 78 state agencies. The cost of a new program will be very difficult to absorb without additional FTEs and other resources.

Below are assumptions made in compiling the information for this estimate. Throughout this section, fiscal year 2016 cost assumptions were used to provide a baseline. However, increases in salary would be incorporated upon implementation and will increase the cost.

[10] If the savings are determined at the end of the biennium and not captured in time to make an award, in most cases the savings cancel back to the General Fund.

Assumptions

Assumptions on Idea Submission Volume

As stated in the fiscal note submitted for S.F. 605, certain assumptions have to be made regarding the scope of work that will be generated by the Gainsharing Program. Additional assumptions include:

- This new program would incorporate applicable best practices of other states' gainsharing programs such as a suggestion process, multi-level review to verify eligibility and merit, approval of awards at the agency and enterprise level, and processes to facilitate reporting.
- Assume an average hourly wage of $32.13 for executive branch full time staff.
- Assume an average hourly wage of $46.73 for executive branch managers.
- Assume a new program would impact the entire Executive Branch including Minnesota State. In 2016, total staffing in the entire Executive Branch including Minnesota State was 52,644 employees.
- Assume one in 100 employees will submit a suggestion every year: 526 suggestions annually.
- Assume that costs for program development, bi-annual reporting and a full time program administrator are incurred solely by MMB; costs for the Gainsharing Suggestion Documentation Process, Agency Review Committee, and Enterprise Gainsharing Committee are incurred by all executive branch agencies.
- Assume that the program will require the addition of at least one full time MMB program administrator (1 FTE) responsible for program development, administration and auditing. It is assumed that the cost of salary, FICA, insurance and retirement for one full time FTE will total about $100,000 annually.

Assumptions on Compliance Objectives

- There is no appropriation for development and implementation of the employee gainsharing program.
- The estimated cost of developing and implementing an employee gainsharing program is approximately $62,000 for the first year of operation.
- The estimated cost of operating an employee gainsharing program annually once developed and implemented is approximately $1.5 million per year.
- The employee gainsharing program must include the appropriate design, implementation, and maintenance of a system of internal controls under Minn. Stat. 16A.057, subd. 1.
- Training will be required for state employees and agency HR personnel, managers, and others involved in the development and implementation of the program to ensure ongoing compliance.
- The employee gainsharing program will be subject to overall monitoring and risk assessment in the same manner as other statewide financial programs or related operations.

Cost Projections

Projections for Administering Gainsharing at Agency and MMB Levels

Once operational, the enterprise Gainsharing Program is assumed to involve a three-step process:

1. **Gainsharing Suggestion Documentation**: At the agency level, employees develop their proposals and the business case for projected cost savings, which would be then reviewed by the employee, appropriate managers and supervisors, budget staff, communications staff, appropriate subject matter experts and the MMB Executive Budget Officer assigned to that agency. Properly vetted proposals would be then forwarded to the Agency Review Committee. It is assumed that costs would be incurred by all agencies in the executive branch.
    - This estimate assumes that 20% of all proposals (105 total proposals annually) would be advanced to the Agency Review Committee.
2. **Agency Review Committee:** Each Agency establishes a process whereby agency human resources, budget personnel, communications staff, and executive leadership review and potentially approve awards up to $1,000. Any proposals that potentially merit an award in excess of $1,000 would be sent to MMB's Enterprise Gainsharing Committee. It is assumed that costs would be incurred by all agencies in the executive branch.
    - This estimate assumes that 5% of proposals considered by the Agency Review Committee, (26 total proposals annually) would be advanced to the Enterprise Gainsharing Committee.
3. **Enterprise Gainsharing Committee**: The Enterprise Gainsharing Committee composed of MMB enterprise human resource staff, statewide budget officers, enterprise communications personnel, and executive branch leadership [Deputy / Commissioner level] would review proposals and authorize awards greater than $1,000 and up to the limits authorized by statute. It is assumed that costs would be incurred by all agencies in the executive branch.

The projections assume that each request would require an average of 50 hours of staff time at the suggestion documentation process level, and that most of the hours would be incurred by staff paid at the full time executive branch hourly wage. The 50-hour estimate assumes that employees seeking a gainsharing award would spend significant time developing their proposals and vetting their viability; it also assumes hour contributions by, at minimum, appropriate managers and supervisors, budget staff, communications staff, appropriate subject matter experts and the MMB Executive Budget Officer assigned to that agency.

The projections assume that the Agency Review Committee would require 8 hours of work per week from one or a combination of multiple staff at each of the 25 cabinet agencies, and 8 hours of work per week from a proportional number of staff representing the dozens of small agencies, boards, and commissions. Total hours per year of staff time is assumed to be equivalent to 27 employees working 8 hours per week on vetting the proposals advanced from the Suggestion Documentation stage. The hour equivalent of 27 employees dedicating 8 hours per week to this process totals 11,232 hours of work in a year.

The projections assume that staff at the Agency Review Committee stage would be in management and paid at the executive branch manager average hourly wage.

The projections assume that the Enterprise Gainsharing Committee would require 5 MMB staff to dedicate about 52 hours to review and vet proposals, confirm the cost savings, and to coordinate all communications related to any awards offered. These projections assume that Enterprise Gainsharing Committee staff would be paid at the executive branch manager average hourly wage.

Biannual Reporting Requirements

The projections assume that the Biannual Reporting requirements would require 10 hours per month for data collection at each of the 25 cabinet agencies, and the equivalent of 250 cumulative hours per month for the dozens of small agencies, boards, and commissions. The projections further assume that most of the hours would be incurred by staff paid at the full time executive branch hourly wage.

The projections assume that the Monthly Reporting requirements would require 60 hours per month by MMB staff to obtain and analyze each agency's data and to create a report as outlined in S.F. 605. These projections assume that the MMB staff compiling the report would be paid at the executive branch manager average hourly wage. It is assumed that costs would be incurred solely by MMB.

The projections assume that the Monthly Reporting requirements would require 10 hours per month for data collection at each of the 25 cabinet agencies, and the equivalent of 250 cumulative hours per month for the dozens of small agencies, boards, and commissions. Included within these hours calculations are assumptions that some of the ideas that have been proposed may contain private or protected data and/or may contain indicia of legal liabilities or vulnerabilities that would be inappropriate for public distribution. The hours' calculation for these projections therefore assume the descriptions of some proposals will need to be rewritten, redacted, or otherwise reviewed and modified before being distributed to MMB for collation and distribution.

Expenditure Formula

Program Development: It is assumed that the development of this program would take 4 to 6 months and require a time commitment from 5 MMB staff members at one quarter time (261 hours each) and 4 managers at one tenth time (104 hours each) during that time. It is assumed that MMB staff would be paid an average of $32.23/hour while managers would be paid an average of $46.73/hour. It is assumed that costs would be incurred solely by MMB.

Program development cost **= (5 MMB staff x 261 hours x $32.13) + (4 MMB Managers x 104 hours x $46.73)**
Program development cost (FY 2017) **= $62,000**

Gainsharing Suggestion Documentation Process: Assume one in 100 employees submits a suggestion every year or 526 suggestions annually. Assume that each request requires 50 hours at the suggestion documentation process level and that most of the hours are incurred by staff paid at the full time executive branch hourly wage of $32.23. Assume that costs would be incurred by all agencies in the executive branch.

Suggestion documentation cost **= (526 suggestions x 50 hours per suggestion) x $32.13.**
Suggestion documentation cost (FY 2018 and annually thereafter) **= $845,000.**

Agency Review Committee: Assume these staff are paid at the executive branch manager average hourly wage of $46.73/hour. Assume 105 requests reach the Agency Review Committee stage each year. Assume costs would be incurred by all agencies in the executive branch.

Agency review cost **= 11,232 hours (107 hours per proposal) x $46.73**
Agency review cost (FY 2018 and annually thereafter) **= $525,000**

Enterprise Gainsharing Committee: Assume staff are paid at the executive branch manager average hourly wage of $46.73/hour. Assume 26 requests reach the Enterprise Gainsharing Committee stage each year. Assume costs would be incurred by all agencies in the executive branch.

Enterprise gainsharing cost **= 52 hours (2 hours per proposal) x 46.73**
Enterprise gainsharing cost **= $2,000**

Monthly Reporting Requirements: Assume agency staff are paid at the executive branch hourly wage of $32.23/hour. Assume MMB staff are paid at the executive branch manager average hourly wage of $46.73/hour. Assume costs would be incurred solely by MMB.

Agency cost for ongoing monthly reporting **= 500 hours/month x12 months x $32.13**
Agency cost for ongoing monthly reporting **= $193,000**

MMB cost for ongoing monthly reporting **= 60 hours x $46.73**
MMB cost for ongoing monthly reporting **= $34,000**

Total monthly reporting costs = $227,000

Program Administrator: Assume an annual cost of $50,000 which includes salary, FICA, insurance and retirement costs.

Total annual program administrator costs **= $50,000**

Table 1. Total Costs for Gainsharing Program: FY 2017 through FY 2021

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Program Development (MMB)	$62,000	$0	$0	$0	$0
Gainsharing Suggestion Documentation (all agencies)		$845,000	$845,000	$845,000	$845,000
Gainsharing Agency Review Committee (all agencies)		$525,000	$525,000	$525,000	$525,000
Enterprise Gainsharing Committee (all agencies)		$2,000	$2,000	$2,000	$2,000
Monthly Reporting Requirements		$227,000	$227,000	$227,000	$227,000
Program Administrator		$50,000	$50,000	$50,000	$50,000
Total Costs	**$62,000**	**$1,649,000**	**$1,649,000**	**$1,649,000**	**$1,649,000**

Concerns with Gainsharing

In preparing a new state employee gainsharing program, several concerns have arisen and must be considered in the implementation of the program.

Unfunded Mandate

As outlined in the previous section, administering a gainsharing program involves a cost of approximately $1.6 million each year once the program is implemented. No appropriation was provided to develop, implement, and administer a new program.

The state has no data to prove that the savings created by a gainsharing program would offset the cost of implementation. The cost-benefit analysis requires further study. The program may have an overall cost to the state.

Difficulty of Budgeting Documented Savings

Gainsharing was developed by the private sector. However, unlike sharing profits in the private sector, government budgets are more inflexible and cannot easily calculate and budget for savings.

Minn. Stat. 16A.09 requires that gainsharing ideas result in documented savings and the award must be paid from the appropriation to which the savings accrued in the first fiscal year in which the savings are realized. When the majority of the savings fall in the second year of an idea's implementation, an employee's financial award will not reflect ongoing savings.

Legal or budget constraints limit the state's ability to use savings for gainsharing. Funds provided by another level of government or an external source must often be used for a specific purpose. For example, the state's use of federal funds is governed by cooperative and grant agreements. Any plan to change the use of these funds, or to retain savings for another purpose, is subject to federal review and approval.

The same kind of constraint may apply to transfers between funds within a jurisdiction. For example, if savings are generated in a fund that receives transfers from another fund, any savings may need to be returned to the originating fund to comply with appropriations law.

Diminished Goal of All State Employees

The gainsharing statute requires that if an employee's job is to explicitly find efficiencies within state programs, those employees are exempt from the program. While the gainsharing program in Minnesota will attempt to find an appropriate list of positions that is ineligible for an award under this provision, it can be argued that sound fiscal management generally assumes that it is every state employee's responsibility to explore and develop efficiencies.

State employees appreciate recognition of the good work they do, however this appreciation need not be in the exclusive form of bonus compensation. In fact, social science studies repeatedly conclude that for all but simple and routine tasks, financial rewards designed to motivate performance actually have the opposite effect. Public recognition by the legislature or the public for good work, for example, would be a welcome, motivating and appreciated form of employee acknowledgement.

It is important to note that the State of Minnesota currently provides monetary and non-monetary recognition to those employees who go above and beyond to deliver outstanding results in the workplace. These rewards and awards encourage exceptional employee performance. Monetary awards are generally capped at a range from $1,000 to $2,000 under the applicable collective bargaining agreement or compensation plan, This range has been found to be sufficient in providing adequate recognition for those who go beyond their day-to-day performance requirements and motivate others to do the same, without the likelihood of causing significant concerns to taxpayers.

Minn. Stat. 16A.90 caps awards to state employees at $50,000. This amount of money is excessive and could lead to a distraction from employees doing the job they are hired for. Gainsharing-type employee award programs in other states all cap the maximum award at a much lower level. Illinois and Alabama cap awards at $5,000, North Dakota caps awards at $4,000, and Indiana at $13,000.

Increased Risk of Waste or Abuse

The motivation of a bonus award of up to $50,000 and the designation of certain employees who are employed specifically to find savings as ineligible for the program has the potential to increase risk of waste or abuse. Numerous employees' jobs throughout the state include the responsibility to find documented savings. A gainsharing program creates a risk of ineligible employees using their expertise in conjunction with eligible employees to submit ideas and then unjustly benefit from the award. Another potential risk is an employee's use of a colleague's suggestion without consent.

Given the potential for increased risk, concentrated efforts to develop and implement preventative and detective control activities will be needed. The extent of specific control activities required to prevent this abuse and potential waste has not been adequately analyzed at the time of drafting this report. MMB is committed to the implementation of internal control structures within any gainsharing program that will provide reasonable assurances that public funds are protected.

THE GREAT SEAL OF THE STATE OF MINNESOTA

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