A Report
to the
Montana
Legislature

Performance Audit

State Employee Settlements: Trends, Transparency, and Administration

Office of the Governor

June 2020

Legislative Audit
Division

18P-04

Performance Audits

Performance audits conducted by the Legislative Audit Division are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Members of the performance audit staff hold degrees in disciplines appropriate to the audit process.

Performance audits are conducted at the request of the Legislative Audit Committee, which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of six members of the Senate and six members of the House of Representatives.

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June 2020

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit examining state agencies entering into state employee settlement agreements.

This report provides the Legislature with information about the use of state employee settlements. We provide information on settlement trends and how state agencies use settlements to resolve disputes with current and former employees. This report includes recommendations for increasing the transparency in settlement processes through greater oversight of agency settlement decisions. A written response from the Governor's Office is included at the end of the report.

We wish to express our appreciation to the Governor's Office, the executive branch agencies, and the judicial branch for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Angus Maciver

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Adam Schafer, Deputy Chief of Staff

Performance Audit

State Employee Settlements: Trends, Transparency, and Administration

Office of the Governor

June 2020 18P-04 Report Summary

State employee settlement costs increased from $354,503 in fiscal year 2014 to $1,339,946 in fiscal year 2018 for a total five-year cost of just under five million dollars. Current agency practices limit transparency in the settlement process. State policy and statute need to be updated to include agency guidance on how to support and report settlement activity.

Context

A state employee settlement (settlement) is an agreement between a state employee and a state agency to resolve differences based on certain terms and conditions, often monetary. Settlements are a tool to help state agencies resolve employee disputes and ongoing personnel issues. However, during our five year review period there was limited guidance for state agencies, no statutory settlement definition, and no centralized oversight of the settlement process, leading to a lack of transparency for settlement activity. The governor's Executive Order No. 6-2019 implemented after the review period has since offered agencies more guidance. As part of our work we requested settlement activity information from the executive and judicial branches for all reported settlements from fiscal years (FY) 2014 through FY 2018. We also obtained and reviewed information to identify unreported settlements. In addition, we reviewed settlement processes and documentation for a sample of 38 settlements at 17 different state agencies to determine how and why agencies entered into settlements with their employees. We reviewed documentation associated with each settlement including personnel files and settlement agreements to determine the support for each settlement.

Results

Settlement costs increased during our review period of FY 2014 through FY 2018. However, the number of settlements during that period varied. The following statistics highlight trends in settlement activity during our audit period:

- Settlement costs increased 278 percent to over $1.5 million (116 percent to over $760,000 if the $575,000 wage claim settlement at the Department of Corrections is removed from consideration) in fiscal year 2018.
- The average cost of settlements increased 215 percent (79 percent increase to over $35,000 if the $575,000 wage claim settlement at the Department of Corrections is removed from consideration) to over $49,000 in fiscal year 2018.
- The annual number of settlements was 25 in FY 2014, peaked at 46 in FY 2016, and was 30 in FY 2018.

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- Non-disclosure agreements or similar provisions were included in 65 percent of settlements.
- The General Fund was the most common funding source accounting for over 46 percent of settlement costs.

Our review of a sample of 38 settlements found state agencies are entering into settlements inconsistently with limited guidance from policy, rule, or statute. This includes no independent review of agency settlement decisions. Employee settlements come at a cost to the state. The 38 settlements we reviewed as part of our sample cost over $3.6 million. Settlements result from diverse situations ranging from discrimination complaints to employee discipline. This makes support for decision-making important to ensuring transparency in the process. During our review, we found inconsistent support for 63 percent of the settlements reviewed. Inconsistent support included limited information from agencies to show why the expenditure of public funds on each settlement was in the best interest of the state. Another limit to transparency is the use of non-disclosure and other similar provisions in settlements. We found the state does not have policy in place instructing agencies to determine when an individual's right to privacy outweighs the public's right to know prior to using a non-disclosure provision.

Our audit report makes four recommendations to improve the settlement process. The recommendations relate to increasing consistency and transparency in the process by:

- Defining what constitutes a state employee settlement and its costs and implementing policy for accurate reporting of settlements.
- Implementing policy establishing required support and settlement language that must be used for all settlements.
- Requiring a balancing test of right to know and right of privacy before implementing non-disclosure or confidentiality agreements in settlements.
- Establishing a centralized review of settlements and implementing policy for that review.

Recommendation Concurrence	
Concur	0
Partially Concur	0
Do Not Concur	2
Montana Legislature	2

Source: Agency audit response included in final report.

For a complete copy of the report (18P-04) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to **lad@mt.gov**; or check the web site at **https://leg.mt.gov/lad/audit-reports**
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Chapter I – Introduction

Introduction

The Senate Majority Leader requested a performance audit of state employee settlement (settlement) activity during the 2017 Legislative Session. Due to this request and legislative interest in settlement activity, the Legislative Audit Committee prioritized a performance audit. After the 2017 Legislative Session, the Montana Senate President and House Speaker appointed a Special Select Committee on State Settlement Accountability (select committee). The creation of this committee was the result of a desire for greater transparency and information on settlement activity in state government and represented a continued legislative interest in settlement activity.

A settlement is an agreement between a state employee and a state agency agreeing to resolve differences based on certain terms and conditions. They can be used as a management tool to limit the cost of resolving employer-employee issues. Expenses for resolving employment issues include many factors such as staff time, administrative leave, and legal costs. This makes settlements an option to limit the state's legal exposure and potential costs. Settlements are frequently administered by the agency where the state employee works. From fiscal year (FY) 2014 through FY 2018, settlement costs to the state totaled just under $5 million. This chapter will introduce the settlement process, including common situations that lead to settlements, and the scope and methodologies of the audit.

How Do Settlements Work?

Settlements arise from many different circumstances including employee discipline, discrimination complaints, class action lawsuits, and other court proceedings. If an agency decides to settle with an employee, they are responsible for determining what steps should be taken to ensure it is done consistently and in the best interest of the state. For our work, settlements were defined as a binding legal agreement between a state employee and the state employee's employer, where the employee receives consideration in exchange for a release of claims against the state. For example, a settlement can be an agreement an employee drop a disciplinary grievance against the state in exchange for agreed-upon terms.

Settlements can arise from any number of unique circumstances. This includes administrative procedures outlined in both agency and state policy to resolve employee disputes. Administrative procedures may involve processes internal or external to the state agency involved. The following bullets represent common administrative processes available to state employees that may lead to a settlement agreement:

- **Employee Grievances**: Disciplinary and grievance processes are established in the Montana Operations Manual (MOM) and implemented internally by each agency. An employee has the right to grieve any formal disciplinary action that results in a suspension without pay, disciplinary demotion, or discharge. An employee can request an administrative hearing from the state Office of Administrative Hearings after the final step of the grievance process. For grievances involving the Collective Bargaining Act, the Board of Personnel Appeals provides appellate level review.
- **Human Rights Bureau (HRB) Complaint**: The Department of Labor and Industry's HRB is a forum external to individual agency processes for the investigation and resolution of claims of discrimination. HRB has its own processes including mediation, investigation, and an appeals process. If the claim is investigated by HRB, they will issue a cause/no cause finding to determine the merit of the original claim. A settlement can be agreed to at any point during HRB's process. HRB must approve the terms of settlements agreed to after a cause finding has been reached in the investigation.
- **Tort Claim**: The Department of Administration's Risk Management and Tort Defense Division handles all tort claims against the state on behalf of the agencies. Torts include claims such as defamation and wrongful discharge. A settlement is a potential tool to avoid defending tort claims against the state in court.

Agencies can use settlements to end administrative procedures they believe could adversely impact the agency. For example, an agency may settle if they believe the administrative procedure will result in high costs to the agency. However, each of these processes could lead to many resolutions outside of a settlement. Administrative procedures have specific processes outlined in policy or statute. However, when an administrative procedure is resolved through a settlement, no further requirements or other guidance is provided in policy or statute.

Once an agency has entered into a settlement agreement with an employee, the settlement should be reported in the State Accounting, Budget, and Human Resource System (SABHRS) if there are monetary terms in the settlement. SABHRS is the state's enterprise accounting system for entering and tracking agency expenditures, including settlements. However, the reporting process relies on agencies to choose from several different settlement-related expenditure codes to self-report settlement information. Also, the agency must decide which of their existing funding sources would be appropriate to pay potential costs of the settlement.

Executive Order was Implemented to Increase Transparency and Reporting Requirements

During the 2019 Legislative Session, the legislature passed House Bill (HB) 532. This bill included provisions to increase statutory guidance in the settlement process. HB 532

was vetoed by the governor. To address parts of the bill, the Governor issued Executive Order No. 6-2019. This included provisions for publishing settlement information to the transparency.mt.gov website and mandating all settlement information be consistently coded in SABHRS. The executive order was made effective during our audit work. While conducting our work and developing findings, we remained cognizant of the executive order.

Audit Scope and Objectives

Prior to our audit there were several high-profile state employee settlement cases which garnered the attention of the public and the legislature. In response, legislators asked our office to provide information regarding the trends of employee settlements from FY 2003 through FY 2018. We provided the information available in SABHRS. Additionally, to get a broader picture of employee settlements, the select committee requested the Governor's Office gather and provide settlement data from each agency for the same period.

During our audit assessment work, we identified risks related to the state employee settlement information gathered for the select committee. We found the data provided by the Governor's Office to the select committee did not align with the SABHRS settlement data. It was clear there was a disconnect between the data sets and more work needed to be done to provide an accurate picture of settlement activity. One reason for this discrepancy was the lack of an established definition of what constitutes a settlement. For example, the select committee provided a narrower definition of settlements that did not include settlements arising from wage claims when requesting data from the Governor's Office,. Also, SABHRS included data outside of settlements between the state and its employees, such as settlements between the state and private entities. We found the lack of established settlement data to be a risk to the transparency of settlement activity across state government.

The issues with existing settlement data and legislative interest in agency settlement practices were factors in determining our scope. We wanted to provide the legislature settlement trend information from data gathered from each agency. To get the data, we requested employee settlement information from all state agencies and the judicial branch for FY 2014 through FY 2018. We did not include the university system in this analysis due to its functional separation from the executive branch under the Montana Constitution. We reviewed settlements for the five-year period from FY 2014 through FY 2018 to ensure agencies were able to provide all applicable support documentation. Secretary of State document retention schedules created a risk agencies may not have retained all applicable documentation prior to FY 2014. We used a broad definition of a settlement to get a more complete picture and better understanding of agencies' use of

settlements. Information requested included employee name, agency, date settlement was signed, funding source, and description of the settlement. Audit assessment work also found state policy, rule, and statute appeared to provide limited guidance to agencies on settlement practices and support for settlement decisions. This highlighted the need to review agency practices to determine the level of consistency in handling settlements in the absence of state level guidance. We focused the audit on gathering information on agency settlement practices to provide a clear picture of settlement activity in state government.

Based on our audit assessment work, we developed two objectives for examining and providing information on settlements:

1. What are the trends in the number, funding sources, dollar amounts, and non-fiscal impacts of settlements between state employees and state government over the last five years in the executive and judicial branches?
2. Do state government agencies have support for entering into settlements with state employees, and the terms of those settlements?

Audit Methodologies

To address these objectives, we completed the following methodologies:

- Requested a list of all settlements between the state and its employees from the executive and judicial branches from FY 2014 through FY 2018.
- Gathered SABHRS data to identify potential unreported settlements. SABHRS information reviewed included administrative leave, leave without pay, pay increases, settlement earnings codes, and sick and vacation time use.
- Compared settlements reported by agency staff to settlement information from SABHRS to determine if any unreported settlements could be identified.
- Formed a master list of all settlements from FY 2014 through FY 2018 and analyzed the data for trends including settlements per year, costs per year, and funding sources.
- Reviewed state policy, law, and rule to determine if there was any guidance for the settlement process.
- Reviewed the 38 highest cost settlements of the 171 total settlements that occurred in our review period. This involved work at 17 agencies reviewing documentation associated with each settlement.
- Conducted agency interviews for each sampled settlement to determine the agencies' processes for agreeing to a settlement.
- Analyzed documented support agencies had for settlement activity we reviewed.

- Interviewed other states to determine their process for entering into and tracking settlements.
- Interviewed stakeholders to obtain their views of state settlement practices.

Report Contents

The remainder of this report includes chapters detailing our findings, conclusions, and recommendations. It is organized into two chapters:

- Chapter II provides information and analysis on settlement activity in the executive and judicial branches and provides recommendations to better define settlements and their costs.
- Chapter III reviews how state agencies enter into and support settlements and provides recommendations to strengthen guidance and consistency in the settlement process.

Chapter II –State Employee Settlement Data Trends

Introduction

State employee settlements (settlements) are used by state governments to resolve disputes with state employees. However, settlements often come with a price to the state. Limited data on settlement activity left the legislature with little information on the use of settlements and their cost over time. To provide a clearer picture we examined the trends in settlements between state employees and state government. We gathered the following details of settlement activity:

- Reason for settlement activity
- Dollar value
- Funding source
- If a confidentiality/non-disclosure clause was used
- If settlements were recorded in State Accounting, Budgeting, and Human Resource System (SABHRS) using a settlement code

We took steps to verify the accuracy of the self-reported settlement data, and worked to identify settlements not reported by the agencies. Based on this information, we provided trend analysis for settlement activity from fiscal year (FY) 2014 through FY 2018. Our review identified increases in settlement costs while the number of settlements peaked and then decreased during our review period.

To understand the quality of the available settlement data, we needed to determine how agencies report their settlement activity. We examined how settlements are defined and reported by agencies, including the accuracy of available settlement data. This chapter provides a look at past settlement activity in the executive and judicial branches and provides a recommendation to improve future settlement reporting.

Agencies Self-Report Settlement Data

To do the trend analysis presented in this chapter, we took steps to ensure we had a more complete list of settlement activity. SABHRS is designed to track agency expenditures, including settlements, through agency reporting. However, we found six settlement account codes in SABHRS from which agencies could choose. Agencies were inconsistent about which code they used to record state employee settlement information. Because of this, none of the available codes offered a reliable picture of settlement activity. To get a more accurate picture of settlements, we asked state agencies to report to us any settlements they entered into from FY 2014 through

FY 2018. Statute does not define settlements or what should be considered in factoring their costs to the state, so we defined settlements as binding legal agreements between a state employee and the state employee's employer, where the employee receives consideration in exchange for release of claims against the state. We asked all executive branch agencies and the judicial branch to report all agreements that fit this definition.

Some Settlement and Cost Information Unreported

The executive and judicial branches self-reported 167 settlements from FY 2014 through FY 2018. Since this information was self-reported we had to take additional steps to determine if it was complete. Consequently, we generated a list of employees who were potentially involved in an unreported settlement. Employees potentially involved in a settlement were selected based on factors such as paid administrative leave use which was common for employees involved in the settlements. We checked with the Human Rights Bureau, Board of Personnel Appeals, and Office of Administrative Hearings to determine if they had been involved with a settlement for those employees. These offices were involved in many of the settlements reported by agencies. We also reviewed the use of the SABHRS settlement earnings code and reviewed documentation on all employees who had this code used to record their earnings to determine if they received a settlement.

Based on this review, we were able to identify four settlements not self-reported by the agencies. This included one at the Department of Livestock, one at the Office of the Commissioner of Higher Education, and two at the Department of Transportation. Agency staff indicated during follow-up interviews these were not reported for multiple reasons including the limited cost of the settlement, reporting oversight, or belief it did not constitute a settlement. The four unreported settlements had a total cost of $42,000.

We also took additional steps to verify the dollar values reported for each settlement to ensure agencies were accurately reporting settlement costs. Our review showed 12 settlements with terms of paid administrative leave or compensatory time payouts that reported no or limited costs for the settlement. For example, one settlement reported a cost of $78,672. However, the terms of administrative leave in that settlement had an additional value of $71,117. To ensure all settlement costs were fully reported, we obtained the cost of paid administrative leave and compensatory time payouts for each settlement that reported it as part of the settlement terms. The costs did not include costs of administrative leave prior to the settlement or compensation time that would have otherwise been paid out. It should be noted that administrative leave costs are recorded in SABHRS as personal services expenditures, but because these are recorded separately in the state's accounting records, they did not get included in the total costs of the settlement. Administrative leave costs were added to settlements reported and

added a total cost of over $225,000 to the reported settlements. Table 1 below shows the inaccuracies we identified in the settlement data reported to us by the agencies from FY 2014 through FY 2018.

Table 1
Missing Settlement and Cost Data

Inaccurate Data Identified	Number of Occurrences	Cost
Unreported Settlements	4	$42,000
Under-Reported Settlement Costs	12	$225,960

Source: Compiled by Legislative Audit Division staff based on agency reports.

The trend analysis in the rest of this chapter is based on the settlement data self-reported by the agencies along with the additional data identified by audit staff.

Analysis of Trends in Settlement Activity FY 2014 Through FY 2018

This section provides our analysis of settlement information for the executive and judicial branches. In the time frame of our review, the state entered into 171 settlements with a total cost of just under $5 million. Only 11 percent of reported settlements came with no cost to the state. No cost settlements included terms such as discipline being removed from an employee's personnel file or an employee returning to their job.

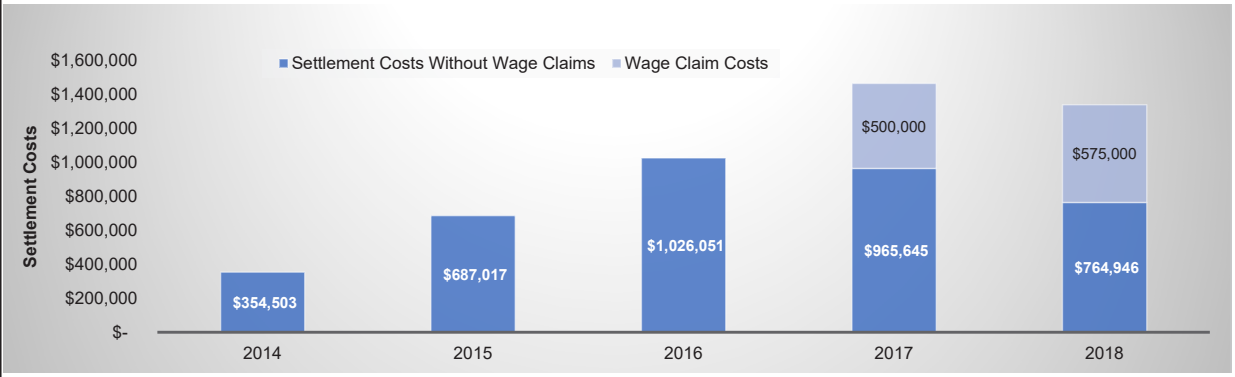
We reached out to Idaho, New Mexico, North Carolina, and Iowa regarding their settlement activity. These states were chosen because they have implemented more structure, through policy and statute, to their settlement processes. They indicated they use settlements in a more limited way. Staff in other states said their terms predominately consist of getting the employee back to work with backpay instead of payouts to the employee. We also found other states had more guidance in policy, rule, and statute for their settlement processes. However, the states we contacted did not have settlement data available for comparison to Montana state government settlement data during the audit time period. Other states reported they saw this as a need and were starting to gather settlement data. These efforts to increase settlement data reporting were driven by recent implementation of settlement review and reporting policy and statute in those states. The sections below discuss our employee settlement trend analysis and shows the settlements agencies entered into during our review period.

Settlement Costs Increased From FY 2014 Through FY 2018

Settlement costs are determined through negotiation between a state agency and the

employee. Negotiations are typically handled by agency management and legal staff. Agencies work with the employee to determine an amount the parties can agree upon to release the state from any further liability in these situations. The cost of a settlement varies based on the scenario and the desired terms of the employee and agency. During our review period, we found employee settlement costs increased by 278 percent, peaking in FY 2017. This increase was driven by two high cost class action lawsuits regarding wage claims settled in FY 2017 and FY 2018. These totaled $500,000 in FY 2017 and $575,000 in FY 2018. Without those two settlements, the cost curve peaks in FY 2016 with slight declines in FY 2017 ($965,645) and FY 2018 ($764,946) for a FY 2014 through FY 2018 increase of 116 percent. The following figure shows the total cost of settlement activity from FY 2014 through FY 2018.

Figure 1
Settlement Costs Peaked in FY 2017

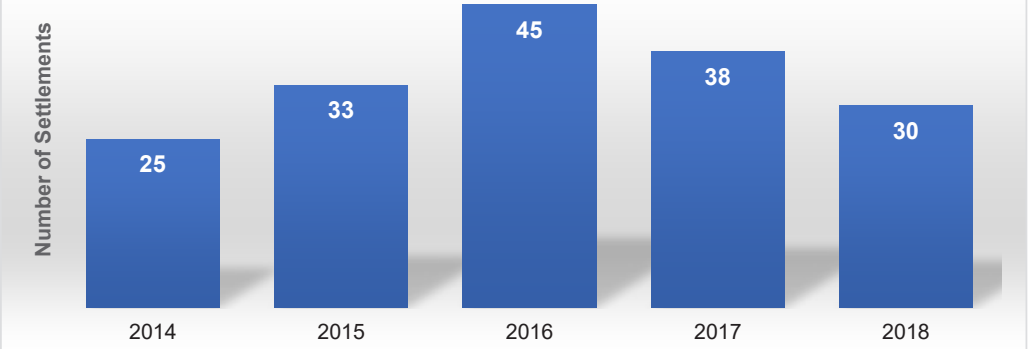


Source: Compiled by Legislative Audit Division staff based on agency reports.

Number of Settlements Peaked in FY 2016

The number of settlements did not show the same growth as settlement costs. The number of settlements peaked in 2016 and returned to below 2015 levels by 2018. This information shows, while settlement activity decreased during the last two years of our review, the total settlement costs increased. Again, this is largely driven by the two high-cost wage claim settlements. Figure 2 (see page 11) shows the total number of settlements for each FY from 2014 to 2018.

Figure 2
Settlement Activity Peaked in FY 2016



Source: Compiled by Legislative Audit Division staff based on agency reports.

Agency Settlement Figures Vary Based on Size of the Agency

The total costs and number of settlements largely corresponded to the size of the agency based on employee counts. Agencies with a greater number of employees, such as the Department of Public Health and Human Services (DPHHS), Department of Transportation, and Department of Corrections, had higher overall settlement costs. This contrasts with smaller agencies, such as the State Library, Montana Historical Society, and Arts Council, who did not report any settlements. Risk Management and Tort Defense (RMTD) is a division of the Department of Administration and represents the state in tort claims. RMTD handled eight settlements with a total cost of $184,800. The settlement costs associated with their division have been distributed to the agencies they were representing when they settled these tort claims.

The number of settlements per agency was closely grouped. There are only two agencies that had over 10 total settlements between FY 2014 and FY 2018. The biggest outlier was DPHHS with 64 settlements. However, DPHHS had one of the lowest average cost of settlements at just over $12,000 per settlement. We also calculated the number of settlements per 100 employees. This provides a look at agency settlement activity without it being skewed by the size of the agency. For example, the Department of Transportation had 15 settlements, but per 100 employees they have fourth lowest settlement rate. Table 2 (see page 12) shows the total settlement costs, number of employees, number of settlements, number of settlements per 100 employees, and average settlement cost by agency from FY 2014 through FY 2018. The employee count for each agency was taken from the first day of FY 2018. The information is organized by the total settlement costs per agency.

Table 2
Settlement Data by Agency
FY 2014-2018

State Agency	2014-2018 Settlement Costs	Number of Employees	Number of Settlements	Number of Settlement Per 100 Employees	Average Cost Per Settlement
Public Health & Human Services	$785,510	3,257	64	2.0	$12,273.60
Transportation	$487,146	2,035	15	0.7	$32,476.38
Fish, Wildlife & Parks	$289,792	1,216	8	0.7	$36,224.00
Revenue	$266,147	639	9	1.4	$29,571.85
Corrections	$243,500	1,091	8	0.8	$34,187.50
Livestock	$210,610	140	4	2.9	$52,652.59
Administration	$204,414	394	9	2.3	$22,712.64
Environmental Quality	$185,562	382	8	2.1	$23,195.30
Justice	$154,676	822	8	1.0	$19,334.55
Natural Resources and Conservation	$139,000	722	3	0.4	$46,333.33
Military Affairs	$133,599	214	4	1.9	$33,399.75
Labor & Industry	$129,000	785	6	0.8	$21,500.00
Public Employees Retirement Administration	$118,666	48	2	4.2	$59,332.92
State Auditors Office	$111,000	77	2	2.6	$55,500.00
Commerce	$108,487	213	3	1.4	$36,162.35
Office of the Commissioner of Higher Education	$95,886	82	4	4.9	$23,971.48
Judicial Branch	$40,000	472	2	0.4	$20,000.00
Office of Public Instruction	$25,000	311	1	0.3	$25,000.00
State Fund	$20,500	295	2	0.7	$10,250.00
School for the Deaf and Blind	$17,500	137	1	0.7	$17,500.00
Public Defender	$17,145	271	5	1.8	$3,429.00
Public Service Commission	$10,000	31	1	3.2	$10,000.00
Lottery	$3,221	34	1	2.9	$3,221.22
Commissioner of Political Practices	$1,800	6	1	16.7	$1,800.00
Total (Average in last two columns)	**$3,798,162**	**13,674**	**171**	**2.4**	**$26,094.94**

Source: Compiled by Legislative Audit Division staff based on agency reports.

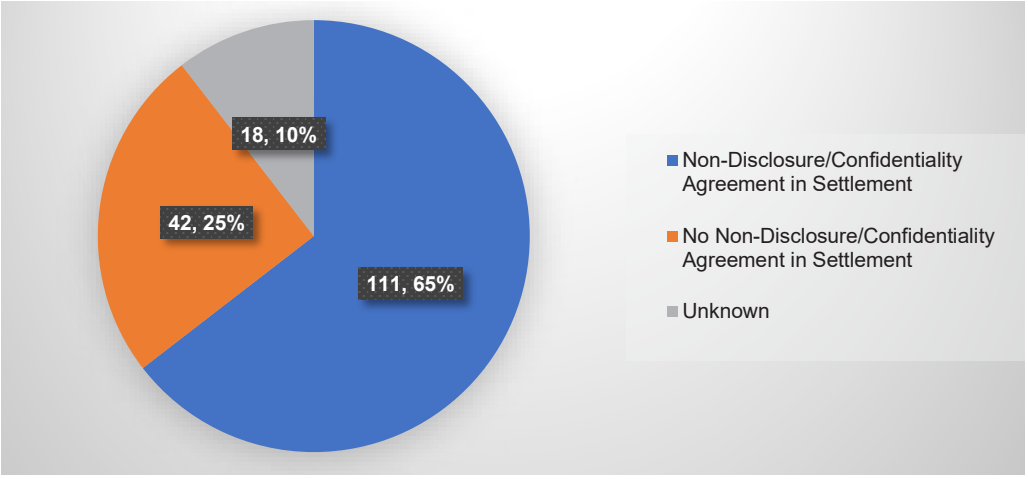
Note: Two wage claim settlements at Corrections totaling $1,075,000 were removed from this table.

Non-Disclosure/Confidentiality Agreements Are a Common Part of Settlement Agreements

Non-disclosure and confidentiality agreements are frequently included in settlements to limit the parties' ability to discuss or disclose details regarding the settlements. Both names were used interchangeably in settlement agreements reviewed. More rarely used in settlements were non-disparagement clauses. These terms can be used in situations where the release of the information could be detrimental to the individuals involved in the settlement. However, based on information provided by agencies, they are not used only for those situations. We found 65 percent of settlements reported included a non-disclosure or confidentiality agreement. In discussion with agency staff, they indicated these clauses are often part of their standard settlement agreements. This limits the transparency of settlement activity to the public.

The following figure illustrates how many reported settlements included a non-disclosure or confidentiality agreement. We also found 18 settlements where the agency did not know if a non-disclosure or confidentiality agreement was used, because they were not able to find the agreement or did not report on its inclusion.

Figure 3
Non-Disclosure/Confidentiality Agreements Common in Settlements



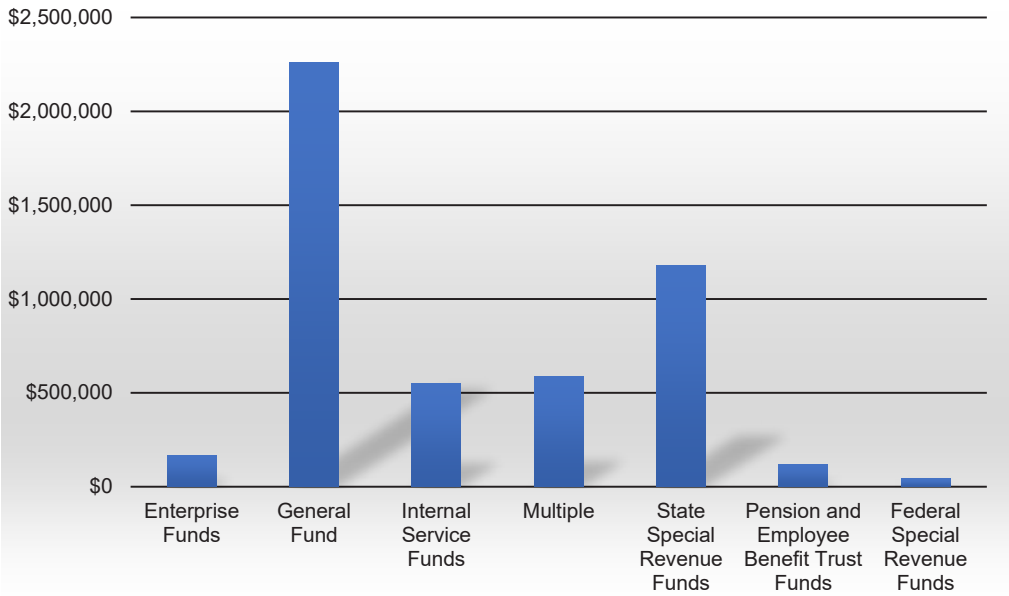
Source: Compiled by Legislative Audit Division staff based on agency reports.

Funding Sources Used to Pay Settlements Varied

Settlements often include payments to an individual as part of the negotiated terms. Our review found a wide variety of funding sources used to make these payments. SABHRS has fund codes based on different types of appropriated funding. Agencies

are responsible for using appropriate funds to pay for settlement activity. We evaluated SABHRS data to determine what fund types agencies used to pay for employee settlements. Our work showed 46 percent of the funding used to pay for settlements from FY 2014 through FY 2018 came from the General Fund. This was followed by State Special Revenue Funds accounting for 24 percent. The following figure provides information on funding sources used to pay settlements.

Figure 4
46 Percent of Settlement Funding Comes from the General Fund



Source: Compiled by Legislative Audit Division staff based on agency reports.

Executive Order Changed Agency Reporting Requirement

Our trend information on agency reported employee settlements showed a general increase in activity from FY 2014 through FY 2018. The Governor issued Executive Order No. 6-2019 instituted a policy shift requiring state agencies to report the date, state agency where claim originated, and the amount paid for every settlement starting in FY 2020 (July 1, 2019). Under this order, settlements must be reported within 30 days of signing the settlement agreement on a publicly available transparency website. The executive order became effective during our audit. Since the executive order's effective date, five settlements have been reported on the transparency website. These settlements had a total cost of $77,830. This represents a significant decrease in the annual settlement trends and their costs from our reporting period of FY 2014 through FY 2018. We did not review the new settlement data as part of our audit work. The Governor's Office issued an informal policy to agency staff to limit future

settlement activity after our reporting period. They believe this accounts for the drop in settlement activity. Reporting settlements to the transparency website is a good step towards improving transparency in settlement activity. However, the change in settlement activity represents a large discrepancy between the trends in our review work and the currently reported data.

Conclusion

Settlement trending data shows overall growth in settlement numbers and costs within state agencies from FY 2014 through FY 2018. Recent reporting on the state's transparency website indicates settlement activity has significantly declined. Our work identified several inconsistencies in the number and costs associated with settlements reported for this audit versus other available settlement data. As a result, we believe greater scrutiny is needed to verify current self-reported information on state settlement activity is accurate and complete.

Accurate Settlement Reporting Limited by Multiple Factors

As illustrated in our work above, analysis of past settlement data trends required an accurate data set. We reviewed available settlement data to determine how agencies reported settlements and the accuracy of that data. We found there was no system in place during our review period to ensure agency reported settlement data was accurate. Agencies are responsible for reporting their own settlements in SABHRS if the settlement includes monetary terms. SABHRS has six account codes that relate to settlement activity, with state agencies individually deciding which codes are appropriate to use. However, not all settlement activity reported with the use of these codes is associated with employee settlements. Some of the settlement activity reported includes settlement activity between the state and other private entities. Statue is currently unclear on how a settlement with an employee is defined and how to accurately report state employee settlement activity.

Agencies Lack Settlement Reporting Guidance

Settlement data not only relies on agencies to self-report settlement information, but relies on them to determine what situations qualify as a settlement and what should be included in the cost of the settlement. Statute does not give a definition of what agreements with employees qualify as a settlement. This alone creates inconsistency in getting an accurate picture of statewide settlement activity. Statute and policy also do not speak to a reporting process for settlement activity. Agencies are responsible for determining what settlement code in SABHRS is appropriate. The Governor's executive order provides structure for the reporting of settlements and a settlement

definition. However, this order does not exist in state policy or statute. It also relies on agencies to self-report settlement information with no oversight. The current lack of policy and statute providing agency guidance has led to a lack of transparency for settlement activity.

No Statutory Definition of Settlements Led to Inconsistency in Reporting

Over the course of our audit, the lack of an established settlement and settlement cost definition has caused confusion and inconsistency in settlement data. Our request for settlement data from the agencies used a broad definition to get as complete a picture of settlement activity as possible. We defined a settlement as binding legal agreement between a state employee and the state employee's employer, where the employee receives consideration in exchange for release of claims against the state.

The Governor's Office provided settlement data to the Special Select Committee of State Settlement Accountability for the same time period as we requested data for this audit. Similar to how we gathered settlement data for the audit, the Governor's Office requested this information from the agencies. Their request included termination settlements, discharge settlements, and uncategorized settlements. Uncategorized included settlements related to reductions in force and negotiated resignations. The data generated from our request and the Governor's Office request were substantially different. The Governor's Office data showed a general decline in the cost of settlement activity from FY 2014 to FY 2018 with over $400,000 in FY 2014 and approximately $200,000 in settlement activity in FY 2018. This contrasts with the settlement trends we discussed earlier in this chapter. Based on self-reported data by the agencies we found $354,503 in FY 2014, and over $760,000 in FY 2018 (excluding a $575,000 wage claim settlement at the Department of Corrections). This shows the importance of defining settlements in a consistent way. Without a consistent definition and defined reporting expectations, the data produced on settlements will vary.

In addition to the reporting inconsistencies created by the lack of an established definition of a settlement, we found inconsistencies in settlement costs. For example, we found some agencies were not including the cost of administrative leave agreed to in the terms of settlements in the costs as discussed earlier in this chapter. Reliable settlement data relies on established definition of settlements and their costs.

Limited Reporting Structure Contributes to Settlement Data Inconsistency

Current statute does not provide for uniform reporting of settlement activity and has contributed to inconsistency in settlement data sets. We reviewed SABHRS data

and found no code that offered a reliable picture of settlement activity. There are six codes in SABHRS related to settlements. None of these codes offer reliable data on settlement activity when compared with the information we gathered and reviewed from agencies. This highlights the risks of having settlement data self-reported by the agencies without clear expectations.

We also assessed how accurately the existing SABHRS settlement codes recorded the settlements reported to us by the agencies. We examined expenditures attributed to each SABHRS settlement code to identify the reported settlements. We found 57 agency reported settlements were not recorded in the SABHRS data. These settlements had a cost of over $2 million. Again, this shows the disconnect between settlement data reported in SABHRS and what was self-reported by the agencies.

Other States Have Statutory Settlement Definitions and Reporting Requirements

For settlements to be accurately recorded, agencies must know what constitutes a settlement and its terms and how to report that information. As part of our work, we reviewed settlement processes in other states and found other states had more clearly defined what constitutes a settlement. In Iowa, state statute defines a settlement as a binding legal agreement between a state employee and the state employee's employer to resolve a personnel dispute including but not limited to a grievance. Other states also have a more structured reporting process for settlements. In North Carolina, the Office of State Human Resources is responsible for review of settlements. Part of their responsibility is to gather data on settlements and report that information to the legislature. This helps ensure settlement data is accurately reported. New Mexico recently implemented an online system where all settlements can be viewed 180 days after they are signed. Again, information is centrally added to that system to ensure transparency to the public regarding spending public money on settlements. In contrast, Montana State government relies on agencies self-reporting and does not define settlements or reporting requirements in statute.

RECOMMENDATION #1

We recommend the Montana Legislature enact legislation:

A. *Defining what constitutes a state employee settlement and what should be considered when determining the cost of a state employee settlement, and*

B. *Requiring reporting of state employee settlements in the State Accounting, Budgeting, and Human Resource System, including defining what information should be reported.*

Chapter III – Limited Support for Settlement Activity

Introduction

State employee settlements (settlements) are agreed to at the discretion of the agency involved. Agency management and legal staff have the latitude to enter into settlements. Settlements are used by agencies to resolve issues with their employees while guarding the state from future liability. The situations leading to settlements are each unique. However, they can involve some common processes such as discipline procedures and discrimination complaints. Agency legal staff or outside counsel, and agency management are responsible for reviewing each unique situation and determining when a state agency should settle with one of its employees.

Prior to our audit, information available on settlements was limited. Limited information was gathered for the Special Select Committee of State Settlement Accountability from the State Accounting, Budgeting, and Human Resource System (SABHRS) and by the Governor's Office from individual state agencies. Based on reported settlement activity we gathered from state agencies, it became clear this information was not complete. Besides the information being incomplete, it did not provide information related to why and how state agencies were entering into settlement agreements. This limits transparency for settlement decisions outside of the agency involved. Often, settlement terms include direct payments to the employee involved. The use of public funds to settle employment disputes requires transparency to ensure this is a prudent use of an agency's limited funding prior to a settlement being finalized.

Our second objective focused on determining how agencies support their decisions to enter into settlement agreements. Generally, we found agencies do not consistently have documented support to show why they entered into their settlements. This chapter focuses on our review of how and why agencies enter into settlements and what support they have for those decisions. This chapter provides recommendations to create greater consistency in the statewide settlement process through increased guidance to agencies and centralized review of settlement decisions.

Limited Guidance in Policy, Rule, or Statute for Settlements

Over the course of our work, we determined there was a lack of guidance in policy, rule, and statute for how agencies should support settlement decisions. We address this issue with the recommendations in this chapter. The expenditure of public money relies on state and agency policy, rule, and statute to ensure the proper use of that funding. This same standard did not apply to settlement activity. Statute provides

some guidance for tort claims and payouts of those claims. For example, it limits and establishes judicial approval for some payouts. However, this applied to a fraction of the settlements we reviewed. Also, in interviews with agency staff, no agency indicated they had established policies or procedure for how to support, report, or establish terms for settlements. Lack of guidance also included the settlement documents themselves. The state does not have guidance for agencies regarding standard language that should be included in settlements to promote consistency or limit legal exposure.

Some agencies indicated they received guidance for settlements from the Governor's Office after the time frame of the audit. The Governor's Office issued an informal policy at a cabinet meeting to limit future settlement activity. In instances where a settlement was necessary, it needed to be brought to the Governor's Office for approval. Some agencies reported receiving this guidance and some had not. Some agencies reported they received guidance to not agree to settlements going forward. To create consistency and transparency in the settlement process, official settlement guidance needs to be formally established and implemented in policy, rule, or statute.

Review of Settlements Found Inconsistency and a Lack of Transparency

To determine how settlement processes are conducted in state agencies, we sampled the 38 highest cost settlements out of the 171 settlements reported by the agencies and identified by audit staff for FY 2014 through FY 2018. We visited each of the 17 state agencies with a settlement in our sample to evaluate how they conducted their settlement process. We interviewed agency staff and reviewed all available documentation maintained by the agency for each settlement in our sample. The documentation offered by the agency typically consisted of personnel files, investigative documentation (if applicable), and the settlement agreement. We reviewed documentation related to the settlements in our sample to determine:

- **What situations led to the settlement**: To determine this, we conducted interviews with agency management and legal staff and verified what they reported through documentation review. This allowed us to understand what happened between the agency and the employee and why the settlement occurred.
- **How the decision-making process for entering into the settlement was supported**: Identifying support for entering into the settlement was based on both interview and documentation review. We interviewed agency staff to determine what led to the settlement and why the agency thought it was necessary and beneficial to the state. Based on this interview, we reviewed documentation related to the settlement to determine if decisions leading to the settlement were supported. We did not question if the agency should or should not have entered into the settlements reviewed. Our review focused on determining if support existed to document the rationale for entering into the settlements.

- **The level of support available for the final terms of the settlement**: The final part of our review was to determine how the agency came to the final terms that were agreed upon in the settlement. We conducted interviews to understand how terms were reached and reviewed available documentation to corroborate that reasoning.

Overall, we found inconsistency in the level of support documentation the agencies provided. Without statewide policy, rule, or statute each agency determined what was appropriate support for the expenditure of public funds on settlements. This inconsistency contributed to a lack of transparency for settlement decisions.

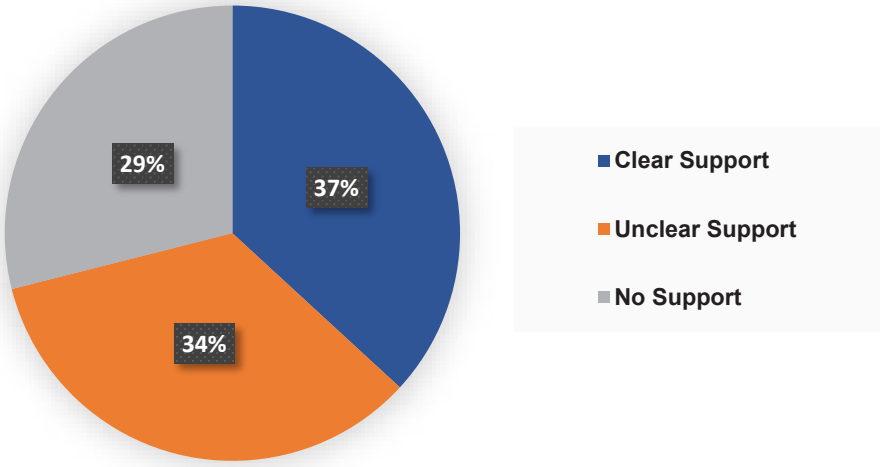
Lack of Support Made the Reason for Settlements Unclear

The inconsistency in settlement support decreased the transparency of agency settlement decisions. During site visits, we found agencies were often unable to provide documentation supporting the decision to enter into the settlements we reviewed. To quantify the level of support agencies had for each settlement, we determined if there was clear, limited, or no support. We defined those in the following way:

- **Clear support** meant the agency had documentation that clearly demonstrated the risks (ex. ongoing litigation, adverse investigative decision) the agency considered in deciding the settlement was beneficial.
- **Limited support** meant the documentation showed there were risks to the agency, but not why a settlement was in their best interest.
- **No support** meant there was no documentation identifying the risk the agency faced or why a settlement was necessary.

We found 24 of the 38 (63 percent) settlements we reviewed had limited or no support for entering into the settlement. The results of our review are shown in Figure 5 (see page 22).

Figure 5
Most Settlements Had Limited or No Support



Level of Support	Number of Settlements	Cost of Settlements
Clear Support	14	$2,125,666
Limited Support	13	$855,647
No Support	11	$635,976

Source: Compiled by Legislative Audit Division staff based on site review.

The following are examples of employee settlements we found to have no or limited support:

- **Limited Support**
  - A manager was investigated for sexual harassment by the Human Rights Bureau (HRB). HRB found no cause, meaning they found no cause to believe an unlawful act had occurred. Agency management we spoke to believe the employee had acted inappropriately. The agency settled with this employee when the individual filed a claim of discrimination with HRB. The agency believed the HRB claim was baseless and was used by the employee as leverage for a settlement.
  - An employee had ongoing documented performance issues. The agency disciplined the employee, and the employee filed a grievance. The agency indicated they settled with the employee to avoid the administrative hearings process. They did not have documentation showing why avoiding the administrative hearings process was beneficial to the agency.
  - HRB and a contracted HR firm conducted investigations of racial and sexual discrimination by an employee. Both investigations found cause to believe the employee had committed the accused offenses. The agency settled with that employee. They believed an appeal of termination by the employee could result in the employee

returning to work at the agency. Agency staff said this was because the employee's manager had not properly reported the employee's sexual and verbal harassment.

- **No Support**
  - ◊ The agency had no documentation related to the situation leading to the settlement or why it was necessary. They indicated there was no one remaining at the agency that had information regarding why a settlement was necessary.
  - ◊ An agency had evidence of poor performance and ongoing discipline against an employee. Agency officials indicated they wanted to give the individual an opportunity to resign and offered the settlement for some security during job transition. The agency said the union was also getting involved and asking for a settlement on the employee's behalf. However, there was no documentation this happened.
  - ◊ An employee was involved in a reduction in force. Neither documentation nor staff could explain why it was necessary to settle with this employee versus going through the typical reduction in force process.

Agencies had support for their settlement decisions in some cases. In these cases, the agency produced documentation showing they had dealt with an employee improperly. For example, one agency had improperly denied an employee Federal Medical Leave Act leave when the employee qualified. In other cases, the agency received a summary judgement against them in court or HRB facilitated a resolution between the agency and the employee. These cases had obvious documented risks that settlements were used to address. However, this level of support was available for 37 percent of the settlements reviewed.

Limited Support for Settlement Terms

We also asked for agency support for the specific monetary terms of each settlement. Agencies were only able to produce documented support for the terms of the settlement in 3 of the 38 cases we reviewed. Proper support for the terms of the settlement meant the agency was able to provide documentation showing they considered factors such as compensation costs or the estimated expenses of ongoing litigation. Generally, the agencies indicated the terms were the result of undocumented conversations among agency management and legal staff. The lack of documentation made it unclear why the agency agreed to the terms of the settlements. For example, the Department of Livestock and an employee agreed to a settlement with terms of $4,090 with an agreement the employee could request more money from the Department of Livestock Board. The employee requested an additional $11,256 for loss of compensation, retirement, and a gap in health insurance coverage. The board agreed to add an additional $12,000 to the settlement. This was more than the request by the employee

and not included in the terms of the settlement agreement. The overall inconsistency in support of these terms made it difficult for the agency to show why the settlement was in the best interest of the state.

Settlement Document Release Language Was Inconsistent

The inconsistencies we identified in employee settlements included the settlement documents themselves. We found settlement documents with different language between agencies and in some cases within the same agency. Some settlement documents were several pages long. These included specific release language that referenced liability releases from specific state and federal statute such as the Family and Medical Leave Act, Americans with Disabilities Act, and others. Other settlement documents were a single page and included limited language without specific release language. Some agencies indicated they had a template settlement document that was adjusted for each settlement. Others indicated they created settlement documents specifically for individual settlements.

Other States Have Standard Support Requirements

We contacted other states to determine what documentation they require for settlements to provide a comparison to Montana. We found examples of other states with more defined documentation requirements when entering into employee settlements. This included a requirement to submit documentation for review when entering into a state employee settlement. This documentation allows a centralized review to determine if the settlement meets required thresholds such as being in the best interest of the state and determining the settlement process was initiated by a filed grievance from an employee. For example, Iowa requires a memorandum explaining the situation and supporting why a settlement should be offered. In New Mexico, the State Personnel Office reviews the settlement and requests additional documentation to verify settlement terms and decisions are appropriate. Also, they introduced a standard template for settlements and distributed it to all state agencies. Staff indicated this was to ensure release language is appropriate and reduces the state's exposure to future litigation. In contrast, in Montana we do not have requirements in policy to guide agencies on how to properly support and document their settlement decisions. However, the Department of Administration's (DOA) role in state government makes them a resource in establishing statewide standards for settlement support and settlement language. They have expertise in legal and human resource matters that are beneficial to establishing settlement standards.

RECOMMENDATION #2

We recommend the Governor's Office work with the Department of Administration to develop and implement policy establishing support documentation requirements and minimum standard settlement language that must be used for all state employee settlements.

Non-Disclosure/Confidentiality Terms Common to Settlements

Non-disclosure, confidentiality, and other similar terms in settlements are a tool to protect the privacy of an individual who would be harmed by the release of settlement information. Agency legal staff indicated these terms are common in state employee settlement agreements. We found state agencies used non-disclosure or confidentiality agreements in most employee settlements regardless of the underlying situation. Our review found 111 (65 percent) of the 171 settlements reported to us by agencies contained these terms.

Review of our sample of the 38 highest cost settlements found similar use of non-disclosure, confidentiality, and similar terms. We found 27 of the 38 settlements included these terms. For the 11 settlements identified where the agency could not provide documented support for why they entered into the settlement, the settlements all included either non-disclosure or confidentiality terms. In these cases, no one outside of the agency would have access to the settlement to scrutinize that decision. One of the unsupported settlements with a confidentiality clause involved an individual who was found to have committed racial and sexual discrimination. This could perpetuate this behavior because future employers would be unable to find out about the employee's past workplace behavior. In general, we found non-disclosure, confidentiality, and similar terms were more common in settlements with less documented support. Table 3 (see page 26) shows the use of these terms in the settlements in our sample based on their level of support.

Table 3
Confidential Settlements Had Limited Support

Settlement Support	Number of Settlements	Number of Settlements With Confidentiality/ Non-Disclosure Provisions
Clear Support	14	6
Unclear Support	13	10
No Support	11	11

Source: Compiled by Legislative Audit Division staff based on employee settlement review.

Non-Disclosure/Confidentiality Agreements Do Not Align With Montana Open Government Provisions

Montana has a culture of open government and well-established right-to-know provisions built into existing laws and the state constitution. For example, §2-3-201, MCA, states the actions and deliberations of all public agencies shall be conducted openly. In addition, a recently issued governor's Executive Order No. 6-2019 says an employee settlement is public information. The only exception is if the right to individual privacy clearly exceeds the merits of public disclosure. However, the executive order does not include a balancing test to determine when privacy outweighs the public's right to know related to the release of settlement documents. In the case of non-disclosure or confidentiality agreements in settlements, a balancing test should determine if the individuals in the settlement have a privacy interest that outweighs the public's right to know. Balancing tests have traditionally been used in court cases when a public records request has been made. For use in determining when to include a non-disclosure or confidentiality agreement in a settlement, a balancing test would need to be adapted to be used by agency legal staff in making this decision. The executive order goes on to assert that a state agency does not have a right to privacy. This language limits the use of non-disclosure, confidentiality, and similar terms, but is not established in statute. The lack of a balancing test when determining if a non-disclosure or confidentiality clause is appropriate has led to common use of these terms without consideration of the public's right to know.

Settlements Are Public Documents in Other States

In New Mexico, statute was recently passed making settlement agreements public immediately after signing. The settlement information is now put on a reporting website that is open to the public. This was in response to uncovered settlements that were determined to be an abuse of power. In Iowa, confidentiality or non-disclosure provisions are not allowed in state employee settlements according to statute. They also

report their settlement activity publicly after the state enters into them. Other states have made it a clear policy choice that settlements must be public to create transparency and ensure they are being used in appropriate situations where they benefit the state. In addition, in Montana §2-9-303, MCA, states that tort claims are public information unless an individual right to privacy clearly exceeds the merits of public disclosure. Montana does not have this type of statutory guidance for state employee settlements.

RECOMMENDATION #3

We recommend the Montana Legislature enact legislation requiring agencies to conduct a documented balancing test of the public's right to know and the individual's right to privacy before including a non-disclosure, confidentiality, or similar terms as part of a state employee settlement.

Lack of Centralized Review Decreases Settlement Transparency

This chapter has focused on the inconsistencies identified by our settlement review. Centralized review is a tool to address these issues. In addition to a lack of documented support discussed earlier in this chapter, another area where we found inconsistency is agency use of fund codes to pay for settlements. As part of our work to compile settlement information, we asked state agencies to provide the fund code used to pay for each settlement they reported for the audit. We subsequently reviewed the fund codes used to pay for the settlements. Through this review we found multiple instances of agencies using inappropriate funding to pay for settlement activity. The following are examples of this:

- A previous Legislative Audit Division financial-compliance report (15-22) found the Department of Livestock paid part of a $189,000 settlement in FY 2015 using inappropriate funding. We found they used the same fund code to pay for part of a $16,000 settlement in FY 2017.
- Funds to support the general operations of the state park system at the Department of Fish, Wildlife & Parks were used to pay $25,000 for a settlement of an employee in a different division of the agency.

Centralized Review Could Improve Employee Settlement Process

A statewide centralized review of agency settlements helps ensure appropriate fund code use, but also coincides with the other issues addressed by the previous recommendations. In each of these areas we discussed issues with inconsistency

across state agencies and the effects of limited guidance. Those same concerns apply to settlements issued without a centralized review. A centralized review can address the effects of the current decentralized process. It can improve employee settlement reporting, decrease inconsistent support for settlements, and reduce inappropriate use of non-disclosure, confidentiality, and similar terms in settlements.

Other States Use Centralized Review to Ensure Justified Settlements

We found other states have a centralized review for all settlement decisions. These reviews take place in what would equate to Montana's State Human Resources Division at the Department of Administration or the Attorney General's Office. New Mexico has administrative code (equivalent to Administrative Rules of Montana) establishing a centralized review of agency personnel settlements by the State Personnel Director. Administrative code requires the State Personnel Office to review each settlement to determine it meets the established standards. Also, the State Personnel Office determines if the settlement is in the best interest of the state, the terms are fiscally reasonable, and the settlement has proper release language.

North Carolina has a similar centralized review by their State Human Resources office. They generally review the settlement to ensure its terms conform with state human resource policy. The State Budget Office determines if the agency has the funding for the settlement terms. In Iowa, a brief is written for each settlement explaining the situation. These briefs must be reviewed by the Attorney General and approved by the director of the Department of Management, the director of the Department of Administrative Services, and the head of the state agency issuing the settlement. Montana does not have statute or policy establishing a centralized review of settlement decisions. This leaves only internal oversight by the agency agreeing to the settlement. The Department of Administration has the technical expertise and experience to carry out centralized review. Once policy and statutory guidance are implemented providing guidance to state agencies on the settlement process the Department of Administration is uniquely suited to carry out a review of those settlement decisions.

RECOMMENDATION #4

We recommend the Governor's Office:

A. *Pursue statute to establish and require a centralized review and approval of all state employee settlements, and*

B. *Work with the Department of Administration to develop and implement policy establishing centralized review which includes but is not limited to a review of:*

- *Funding Source*
- *Settlement Terms*
- *Support for Settlement*
- *Settlement Language*

Office of the Governor

Governor Response

OFFICE OF THE GOVERNOR
STATE OF MONTANA

STEVE BULLOCK
GOVERNOR

MIKE COONEY
LT. GOVERNOR

June 10, 2020

Angus Maciver, Legislative Auditor
Legislative Audit Division
PO Box 201705
Helena, MT 59620

Re: Performance Audit 18P-04

Dear Mr. Maciver:

Below are the responses to each of the recommendations made by the Legislative Audit Division (LAD). Generally, while agencies of the executive branch represented in the audit agree with the audit's recommendation for transparency and consistency in reporting (which has improved substantially during the Bullock Administration), they do not concur with some of the audit's specific recommendations because they are duplicative of existing requirements set forth by the Governor through executive order.

While the agencies represented in the audit also appreciate and acknowledge LAD's willingness to consider concerns about the tone and presentation of the audit and to make adjustments, five concerns remain regarding the final audit as written:

(1) A fifteen-year longitudinal study of state employee settlement activity ordered by the Legislature showed relatively constant, decreasing settlement activity since 2003. For this reason, the executive branch agencies that are the subject of this audit are concerned that the presentation of information in the audit could, in places, be misleading or sensationalize human resources functions that are routine to large employers. For example, the conclusion that settlements have increased by a large percentage is driven entirely by LAD's decision to start the audit period in 2014. Had the period begun in 2016, the data would show the opposite conclusion: a large decrease.

The audit uses 2014 as a baseline and then compares the remaining years to this baseline. Because this issue has never been the subject of an audit, it's not clear if 2014 is a proper base year for settlements or not. Further, percentage changes in the average of a sample size this small are not reliable and can improperly slant the results. Nonetheless, the LAD has concluded that settlements have increased, and it is this conclusion that drives the audit's recommendations. Again, however, if the audit used 2016 as a baseline (without the wage claim settlements discussed below), the conclusion would be that settlements have decreased over time.

In the longest longitudinal study available on this topic, the Legislature examined employee termination settlements dating to 2003. Data for the Legislature's research on executive branch agencies showed a decrease in settlement frequency, average size, and total spending over the longer fifteen-year longitudinal study period. That data is consistent with the fluctuations documented by LAD during its shorter audit window, while providing a broader context from which to draw conclusions about employee settlement activity over time.

(2) LAD acknowledges that there is a lack of data in other states or for comparable employers on employee settlements. In fact, the draft report only identifies three other states in the country that follow a reporting structure similar to what the audit proposes. As a result, the audit lacks context because no comparison is made with states or private businesses with similar budgets or numbers of employees. For example, the report does not consider whether 172 settlements over 4 years is reasonable for an employer with over 11,000 employees. It may be the data in the report is consistent with comparable entities, but there is simply no way to know because the comparisons have not been made.

(3) The audit also includes a small number of large wage adjustment settlements, which were purposefully excluded from the request made by the legislative committee in 2018. That committee focused on employee terminations, and excluded mass wage adjustments that LAD has chosen to include. While we appreciate that LAD has drawn out this information in some charts, overall statements about increases that include these figures skew the findings of the audit.

(4) Further, the characterization that some settlement data was "missing" or "unreported" could also be misleading to readers. To be clear, LAD asked agencies to search for settlement data under certain parameters. This was the "report" requirement. LAD then searched under different parameters, with different results. This was the "unreported" data—merely a separate LAD search. This should not be characterized as agencies doing anything other than following LAD's direction. Calling the different results from LAD's different search "missing" or "unreported" data could lead a reader to conclude that state agencies acted in some untoward way—something LAD acknowledges it did not find, and does not intend to suggest by way of this audit.

In addition, the "missing" or "unreported" data LAD identified amounts to a grand total of four cases not identified by its initial search direction to agencies. The cases also amount to less than one percent of the total settlement dollars identified in the audit.

(5) Finally, LAD's language that settlements "are not supported" could mislead a reader to conclude that agencies entered into employee settlements that were not "justified" or were substantively poor decisions. LAD acknowledged in the exit interview that this is not its intent, and its focus is only on the presence or absence of writings produced as an agency considers the risks and liabilities associated with settlement or protracted litigation. But the choice of language in the audit could easily lead to a different conclusion for the citizen readers who are the ultimate audience for the Legislative Audit Committee's work.

As you know, the Governor issued Executive Order No. 06-2019 on May 10, 2019, requiring public access to employee settlement information. The Order, among other things, defines what is an employee settlement, requires that the settlements be consistently coded in the State Accounting, Budgeting, and Human Resource System (SABHRS), and provides that the Department of Administration may periodically audit state agencies to review compliance with and consistency of the coding. The Order's requirements already cover much of what LAD has focused on in its audit and satisfy most of its recommendations.

In summary, executive branch agencies and the LAD staff have the same goals regarding employee settlements: provide a transparent and consistent database where the public can review employee settlement information. The Executive Order and existing law, particularly addressing the public's right to know and the right to privacy, address these goals in an effective and efficient manner.

Settlements are a function of labor laws that strike a balance between employees and employers. In many cases, though little acknowledged in the audit, the purposes of a settlement are to save taxpayer money and to avoid the cost of protracted litigation. The best information available is that settlement activity in the state fluctuates within a limited range and is decreasing over time.

RECOMMENDATION #1
We recommend the Montana Legislature enact legislation:
A. Defining what constitutes a state employee settlement and what should be considered when determining the cost of a state employee settlement, and
B. Requiring reporting of state employee settlements in the State Accounting, Budgeting, and Human Resource System, including defining what information should be reported.

Response: This recommendation is directed to the Legislature.

RECOMMENDATION #2
We recommend the Governor's Office work with the Department of Administration to develop and implement policy establishing support documentation requirements and minimum standard settlement language that must be used for all state employee settlements.

Response: Do not concur.

This recommendation is largely duplicative of existing efforts and available resources.

As noted above, Executive Order No. 06-2019 allows the public easy access to employee settlement information through the website transparency.mt.gov. Specifically, the Department of Administration is tasked with monitoring, maintaining, and updating, on an ongoing basis, the settlement information on the transparency website. Each agency is required to report to the department the (a) the Employee Settlement Date; (b) the State Agency where the alleged acts or omissions giving rise to the Employee Claim originated; and (c) the amount paid. The information must be reported to the Department of Administration within 30 days of the settlement date and published on the website within 60 days of the settlement date. Each employee settlement published on the website must remain posted for at least three years after the settlement date. The department can, as an administrative task, determine if an agency is properly following the reporting

requirements. And, finally, the department has established consistent coding for settlements as defined.

Further, the recommendation does not define what documentation LAD believes would be adequate for its purposes—or the specific kinds of documents LAD wished to see, but did not, in the 38 cases it reviewed.

The audit does not acknowledge that settlements are entered into when there is disputed liability because the parties agree to disagree. This is the nature of most settlements in any legal dispute and is not unique to the employment law context. The audit does not discuss with any detail that protracted litigation often does not further the state's interests, and the goal of ending the dispute without protracted, expensive litigation can be defeated through unnecessary requirements. The audit proposes minimum documentation standards but does not recognize that treating this form of litigation differently than other litigation could lead to discovery issues that would disadvantage the State of Montana. Further, agency legal counsel or human resources professionals are already able to work across agencies and professional organizations to obtain model settlement documents and modify them for specific cases. An executive order is not necessary to make those resources available.

Most agencies already use a template that has minimum standard settlement language. Not all settlements will use identical language because the circumstances of each case will dictate what provision(s) to include or exclude. And, the agencies who have worked on these cases likely know much more than the Governor's Office or the Department of Administration about the nuances of each case that necessitate the use of specific settlement language or not.

The executive branch agencies that are the subject of this audit will continue to work with the Department of Administration to implement the requirements of the Order.

RECOMMENDATION #3
We recommend the Montana Legislature enact legislation requiring agencies to conduct a documented balancing test of the public's right to know and the individual's right to privacy before including a non-disclosure, confidentiality, or similar terms as part of a state employee settlement.

Response: This recommendation is directed to the Legislature.

Of note, however, the Executive Order clearly provides that employee settlements are public information unless the demands of individual privacy clearly exceed the merits of public disclosure.

Further, as a general matter, the executive branch agencies that are the subject of this audit are wary of creating new statutes to address a well-defined constitutional process. When the Department of Revenue attempted to address such matters in administrative rules, the Supreme Court overturned the agency rule. *AP, Inc. v. Mont. Dep't of Revenue*, 2000 MT 160, 300 Mont. 233, 4 P.3d 5. Rather than enacting legislation that could create confusion and lead to litigation, the approach set forth in the Executive Order utilizes a well-established constitutional process which recognizes the need to balance the public's right to know with individual privacy interests when entering into employee settlements.

RECOMMENDATION #4

We recommend the Governor's Office:

A. Pursue statute to establish and require a centralized review and approval of all state employee settlements, and

B. Work with the Department of Administration to develop and implement policy establishing centralized review which includes but is not limited to a review of:

- *Funding Source*
- *Settlement Terms*
- *Support for Settlement*
- *Settlement Language*

Response: Do not concur

This recommendation is largely duplicative of existing efforts and available resources.

The executive branch agencies that are the subject of this audit currently follow a process that requires review by the Governor's Office for the settlement of employee claims. The number of settlements and the size of those settlements does not call for additional remedies beyond the Executive Order.

Office of the Governor