

# **State of Arizona Office of the Auditor General**

**SPECIAL AUDIT**

## **ARIZONA WORKS PILOT PROGRAM**

**Report to the Arizona Legislature  
By Debra K. Davenport  
Auditor General  
January 2002  
Report No. 02-01**

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AUDITOR GENERAL

STATE OF ARIZONA  
OFFICE OF THE  
AUDITOR GENERAL

WILLIAM THOMSON  
DEPUTY AUDITOR GENERAL

January 25, 2002

Members of the Arizona Legislature

The Honorable Jane Dee Hull, Governor

Members of the Arizona Works Agency Procurement Board

Transmitted herewith is a report of the Auditor General, an audit of the Arizona Works pilot program pursuant to Arizona Revised Statutes (A.R.S.) §46-342.01. This audit was conducted under the authority vested in the Auditor General by A.R.S. §41-1279 et seq. I am also transmitting with this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Arizona Works Agency Procurement Board (Board) was unable to reach an agreement regarding the first finding. In addition, both recommendations are contingent upon the Legislature continuing the program. The Board will implement three of the four recommendations from the second finding, but notes that it will not be able to unilaterally amend the contract to implement the fourth recommendation.

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

This report will be released to the public on January 28, 2002.

Sincerely,

Debbie Davenport  
Auditor General

Enclosure

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## SUMMARY

The Office of the Auditor General has conducted an audit of the Arizona Works pilot program pursuant to Arizona Revised Statutes (A.R.S.) §46-342.01. This audit was conducted under the authority vested in the Auditor General by A.R.S. §41-1279 et seq.

Laws 1997, Chapter 300 and Laws 1998, Chapter 211 established the Arizona Works pilot program (pilot program). The pilot program is a 4-year, two-phase project that was created to determine the feasibility of privatizing public assistance administration. Phase I of the pilot program currently operates in a portion of the metropolitan Phoenix area (hereafter referred to as the pilot area). Phase II, which has yet to be implemented, will expand the pilot program into a rural area. The Arizona Works Agency Procurement Board (Board) was charged by statute with establishing the pilot program and continues to oversee it. The pilot program is operated by a private contractor and replaces the Department of Economic Security's (DES) EMPOWER Redesign public assistance program in the pilot area.

### **Pilot Program Has Not Met Goal of Reducing Administrative Costs (See pages 11 through 16)**

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*Costs higher than DES'  
estimated costs.*

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The pilot program is required by statute to save a minimum of 10 percent in administrative expenses when compared to the estimated cost of running EMPOWER Redesign in the same area. When the pilot program was created, the Board worked with the Joint Legislative Budget Committee (JLBC) staff and DES to develop formulas to calculate payments to the contractor that would be 90 percent or less than DES' estimated cost. Additionally, the formulas calculate incentive payments made to the contractor for meeting performance targets. However, the pilot program's costs were actually higher than the estimated cost of operating EMPOWER Redesign. For example, in fiscal year 2001, the total amount paid to the contractor was approximately \$1.4 million, or 34 percent, more than EMPOWER Redesign's estimated costs.

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*Payments were not reduced after changes in program scope.*

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Program costs were higher because contractor payments were not reduced to reflect two federal decisions that impacted the pilot program's scope and operation. First, when the pilot program was originally conceived, the contractor was to perform eligibility and benefit assessments for the Temporary Assistance for Needy Families (TANF) program and the Food Stamp and Arizona Health Care Cost Containment System (AHCCCS) programs as well. However, the federal government denied Arizona's request to allow a private contractor to conduct the eligibility and benefit assessments for the Food Stamp and AHCCCS programs. The contractor then contracted back with DES to conduct these functions and the contractor's guaranteed payment was reduced accordingly. However, the incentive payment was not similarly reduced. Although our legal analysis found that the incentive payment formula could have been revised, the Board did not change the incentive payment formula. Not changing the formula, however, contributed to the program's failure to achieve the mandated 10 percent savings. For example, the incentive payment in 2000 was over \$1,076,000. If the incentive payment formula had been adjusted to reflect the exclusion of the Food Stamps and AHCCCS functions it would have been approximately \$500,000.

Second, the original pilot program's estimated cost reflected DES' previous practice of allocating certain Food Stamp and AHCCCS costs to the TANF program. Prior to the pilot program, DES was able to charge caseworker salaries to the TANF program even though some caseworkers were also performing eligibility and benefit assessments for the Food Stamp and AHCCCS programs. The federal government now requires that program costs be allocated to the benefiting individual programs. Therefore, these costs should have been removed from the contract payment formulas and the contractor payments reduced accordingly. DES attempted to negotiate an amendment to the contract to resolve this problem in 2001; however, the contract was not amended until 2002.

Beyond the amount paid to the contractor, DES is also incurring additional administrative costs related to the pilot program. DES

has contract administration responsibilities, which include compliance reviews and other monitoring tasks. In addition, as of fiscal year 2002, DES is responsible for providing administrative assistance to the Board. Although a private contractor previously provided this service for approximately \$300,000 per year, DES has received no funding. Finally, DES continues to conduct Food Stamp and AHCCCS eligibility and benefit assessments for clients in the pilot area because the federal government did not allow the contractor to provide these services. This has caused inefficiencies and some duplication of effort for DES and the contractor.

If the pilot program is continued beyond its statutory end date, changes are needed in the payment formula so that the State can achieve the intended savings. In addition, the Board should ensure the formulas: 1) are calculated using the most recent budget cost estimates and expenditures; 2) take into account changes in client caseload; and 3) are appropriately documented.

**Contractor Performance Could  
Be Difficult To Measure Due To  
Recordkeeping Problems  
DES Identified  
(See pages 17 through 20)**

Two DES reviews of the contractor's records identified problems that could potentially impact contract incentive payments and the ability to document compliance with federal requirements. The contractor must prepare and maintain records regarding client employment and job training activities. These records are needed to document the program's compliance with federal requirements governing public assistance programs. The records also serve as a basis for demonstrating client compliance with program requirements as well as documenting the contractor's efforts toward meeting its performance targets. However, DES has identified problems with the contractor's records in two recent contract compliance reviews. Problems included a lack of documentation regarding hours that clients worked, why clients were not being sanctioned for not working or participating in job training activities, and whether client employment was verified.

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*DES found records were incomplete regarding client employment.*

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DES should continue its contract monitoring, but additional oversight is needed. The Board should require the contractor to improve its recordkeeping because incomplete records can potentially have a number of negative consequences. Specifically:

- DES may make inappropriate performance incentive payments if basing these payments on incomplete or inaccurate records.
- Clients may not receive services they need or may not be sanctioned for nonparticipation in work-required activities.

### **Other Pertinent Information (See pages 21 through 22)**

During the audit, other pertinent information was collected regarding the delay in implementing Phase II of the Arizona Works pilot program. By statute, Phase II should have been implemented by April 1, 2001. Although the Board initially selected Mohave County as the site for Phase II in June 2000, conflicts over contract cost negotiations delayed implementation. Eventually, these conflicts and delays led the Board to reverse its decision and to vote against the Mohave County site in October 2001. The Board then had to restart the process to select another site. In December 2001 the Board selected Greenlee County as the site for Phase II.

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# INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted an audit of the Arizona Works pilot program pursuant to Arizona Revised Statutes (A.R.S.) §46-342.01. This audit was conducted under the authority vested in the Auditor General by A.R.S. §41-1279 et seq.

## Arizona Works Pilot Program

Laws 1997, Chapter 300 and Laws 1998, Chapter 211 established the Arizona Works pilot program (pilot program). The 4-year, two-phase pilot program was created to determine the feasibility of privatizing public assistance administration in the State of Arizona. Phase I of the pilot program currently operates in a portion of the metropolitan Phoenix area (hereafter referred to as the pilot area) (see Figure 1, page 2). Phase II, which has yet to be implemented, will expand the pilot program into a rural area.

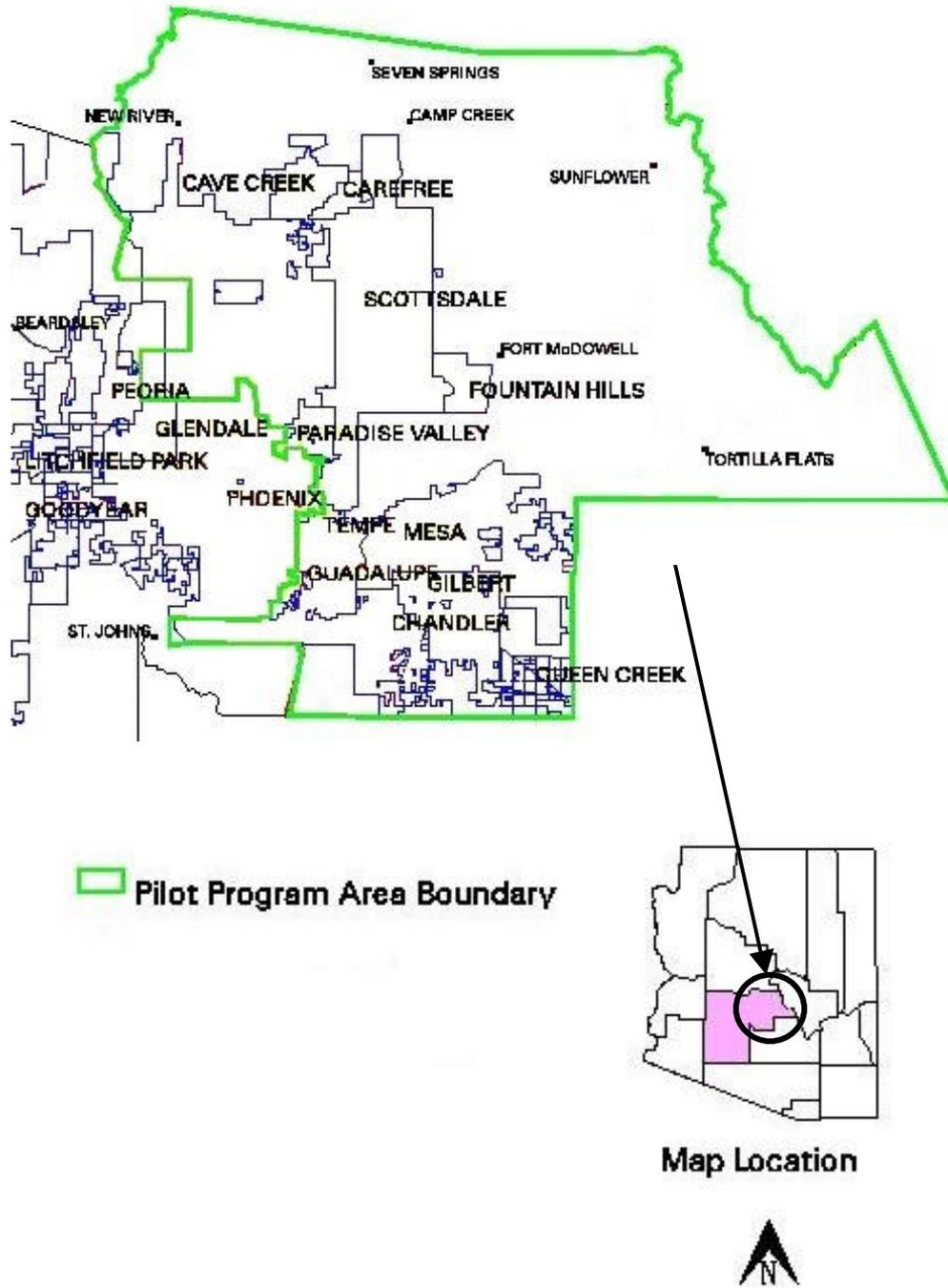
In the pilot area, the pilot program replaced the Department of Economic Security's (DES) EMPOWER Redesign public assistance program. DES continues to administer EMPOWER Redesign in the remainder of the State. Both Arizona Works and EMPOWER Redesign are part of the national welfare reform trend to increase client self-sufficiency through employment and training. However, Arizona Works has several features that differ from EMPOWER Redesign. These include the following:

<p><b>Program Benefits</b> Families eligible for the Arizona Works program can receive:</p> <ul style="list-style-type: none"><li>■ Cash assistance from \$350 to \$390 per month;</li><li>■ Job training;</li><li>■ Job placement assistance; and</li><li>■ Childcare assistance.</li></ul>
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- It is operated by a private contractor.
- It is required by statute to save a minimum of 10 percent in administrative costs as compared to what DES would likely spend in operating EMPOWER Redesign in the same area.

**Figure 1**

**Arizona Works Pilot Program  
Phase I Pilot Area  
As of November 30, 2001**



Source: Arizona State Land Department Geographic Information System.

- It has provisions for payment incentives and penalties to help ensure the contractor meets performance goals.
- It includes more stringent work requirements for public assistance recipients because fewer activities qualify as work.

The first phase of the pilot program began on April 1, 1999, and will continue through December 31, 2002. The pilot area accounts for approximately 13 percent of the State's households that receive benefits and services under Temporary Assistance for Needy Families (TANF), a federally mandated program that provides much of the funding for the pilot program. Phase II of the pilot program was to begin in April 2001, but as of December 2001, it had not been implemented for a number of reasons (see Other Pertinent Information, pages 21 through 22).

### **Federal Decision Impacted Pilot Program Implementation**

The State was not able to implement the pilot program as originally proposed. The enabling legislation called for the State to contract with a private contractor to operate public assistance programs such as TANF, Food Stamps, and the Arizona Health Care Cost Containment System (AHCCCS). Because these are federal programs, the federal government must approve a state's request to operate the programs in a manner that contradicts the programs' federal requirements. In this case, the federal government denied Arizona's request to allow a private contractor to conduct eligibility and benefit assessments for the Food Stamp and AHCCCS programs. As a result, the contractor is now only responsible for eligibility and benefit assessments for TANF, childcare assistance for TANF-eligible clients, and state-funded general assistance. The contractor is also responsible for TANF

Due to the federal refusal to allow the contractor to conduct Food Stamp and AHCCCS assessments, both the contractor and DES perform the following tasks to operate public assistance programs in the pilot area:

- Determining whether clients are eligible for the program;
- Assessing client needs and determining appropriate benefits and services; and
- Monitoring client progress.

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*Federal waiver denial resulted in inefficiencies and duplication of effort.*

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clients' job training and placement. DES continues to perform eligibility and benefit assessments for Food Stamps, AHCCCS, and non-TANF childcare programs in the pilot area.

### **Key Agencies and Their Pilot Program Responsibilities**

The pilot program has a complex administrative structure that includes four primary parties involved in its establishment and administration:

- **Arizona Works Agency Procurement Board (Board)**—The nine-member Board is appointed by the Governor and consists of the DES director, two private-sector members with procurement experience, two community-based organization members, two representatives of a major employer in the State, and two small business representatives. The Board's responsibilities include overseeing implementation of the pilot program, selecting the contractor, overseeing contracted evaluations of the pilot program, monitoring pilot program implementation, and mediating any contract issues between DES and the contractor. The Board initially received administrative support from a private contractor for approximately \$300,000 per year. However, in fiscal year 2002, DES assumed the administrative support function for the Board.
- **MAXIMUS, Inc.**—MAXIMUS, Inc., the contractor selected to operate the pilot program, is a firm with experience in the administration of various aspects of public assistance programs throughout the United States. It is responsible for operating the pilot program according to statute and contract requirements. Requirements include submitting monthly billings to DES and bimonthly progress reports to DES and the Joint Legislative Budget Committee (JLBC).
- **Department of Economic Security**—DES has retained a number of responsibilities related to the pilot program, such as the administration and distribution of benefit and client support service payments for the pilot area, providing computer services and support for the contractor, processing benefit appeals, and performing client fraud and abuse spe-

cial investigations when necessary. Additional responsibilities include assisting JLBC staff in developing the original baseline cost estimate used to establish pilot program funding, making payments to the contractor, monitoring the contract to ensure state and federal program compliance, and assuming all administrative support functions for the Board as of July 2001.

- **Joint Legislative Budget Committee and its staff**—The JLBC and its staff have responsibilities associated with pilot program costs and evaluations. The JLBC staff develops, and the JLBC has the statutory responsibility to approve the original baseline cost estimate for the pilot area. Other JLBC responsibilities include determining the cash benefit savings attributable to caseload reduction, evaluating the pilot program's fiscal and performance impacts, reviewing bimonthly program reports submitted by the contractor, and making recommendations to the Legislature and Board regarding program performance.

### **Contract Process and Payment Formulas**

In order to implement the pilot-program-enabling legislation, the Board issued a Request for Proposal (RFP) in August 1998. This RFP included payment formulas developed to implement the statutory 10 percent savings requirement. To create these formulas, the Board worked with DES and JLBC staff to establish a baseline cost estimate for DES to operate EMPOWER Redesign in the pilot area. This baseline cost estimate included factors such as client caseload and estimated direct and indirect DES costs. In order to achieve the mandated savings and provide incentive payments, the Board devised the following payment structure:

- First, the contractor receives a guaranteed payment. This guaranteed amount is approximately 80 percent of the baseline cost estimate. The contractor bid this amount for the contract.
- Second, the contractor may earn incentive payments. These incentive payments are earned when the contractor success-

fully fulfills established performance measures, such as exceeding EMPOWER Redesign job placements by 30 percent. In the first year of the contract, the amount available for incentives was the difference between the contractor's bid and the baseline cost estimate. In subsequent years, incentives were reduced to the difference between the bid and 90 percent of the baseline cost estimate.

- Finally, the contractor can receive caseload reduction payments that are not included as part of the 90 percent statutory cap. The contractor can receive up to 25 percent of the State's caseload reduction savings that are attributable to the pilot program. JLBC staff calculates this amount annually.

The contractor was awarded a multi-year contract in January 1999 for both Phase I and Phase II of the pilot program. During the term of the contract, DES is responsible for notifying the contractor and the Board of any changes in available funding or scope of work. The contractor has 30 days to respond to proposed changes. Any changes to the contract are negotiated between the contractor, DES, and the Board, and are approved by the Board.

### **Budget**

The pilot program is primarily funded with TANF, Child Care and Development Block Grant, and State General Fund monies. Total contract payments for fiscal year 2001 were slightly more than \$6 million. Table 1 (see page 7) illustrates the pilot program's actual and estimated revenues and expenditures for fiscal years 2000 through 2002.

### **Previous Pilot Program Reviews**

The Board has contracted with an independent evaluator (Abt Associates) to conduct evaluations of the pilot program each program year. As of December 2001, the evaluator has completed two evaluations. A third study is expected to be released

**Table 1****Arizona Works Pilot Program  
Schedule of Revenues and Expenditures<sup>1</sup>  
Years Ended or Ending June 30, 2000 through 2002  
(Unaudited)**

	<b>2000 (Actual)</b>	<b>2001 (Actual)</b>	<b>2002 (Estimated)</b>
Revenues:			
State General Fund appropriations <sup>2</sup>	\$ 367,300	\$ 363,064	\$ 43,000
Temporary Assistance for Needy Families Grant	4,921,865	5,082,418	4,206,200
Child Care and Development Block Grant	688,023	593,751	404,800
Other		<u>10,687</u>	<u>7,300</u>
Total revenues	<u>5,977,188</u>	<u>6,049,920</u>	<u>4,661,300</u>
Expenditures:			
Contract payments to MAXIMUS, Inc.: <sup>3</sup>			
Guaranteed administrative payments	4,600,695	4,624,368	3,152,700
Incentive payments:			
Administrative savings <sup>4</sup>	1,076,493	1,111,000	1,508,600
Caseload reduction savings		14,552	
Contract payments to Fox Systems, Inc. <sup>2</sup>	<u>300,000</u>	<u>299,139</u>	
Total expenditures	<u>5,977,188</u>	<u>6,049,059</u>	<u>4,661,300</u>
Excess of revenues over (under) expenditures	<u>\$ 0</u>	<u>\$ 861</u>	<u>\$ 0</u>

<sup>1</sup> The schedule presents amounts related to contractor payments. It does not include benefit payments or Department of Economic Security (DES) administrative costs. For example, DES has retained a number of pilot-program-related responsibilities, such as administrating and distributing benefit and client support service payments for the pilot area. DES also assumed responsibilities such as contract negotiations and monitoring.

<sup>2</sup> In 2000 and 2001, DES was appropriated \$300,000 from the State General Fund to pay for administrative and technical assistance to the Arizona Works Agency Procurement Board. However, the appropriation was discontinued for 2002, and DES became responsible for assisting the Board.

<sup>3</sup> MAXIMUS, Inc. earns guaranteed administrative payments, which are the base contract amounts for administering the pilot program. MAXIMUS, Inc. also receives incentive payments for meeting established performance measures for administrative and caseload reduction savings.

<sup>4</sup> As of November 30, 2001, administrative incentives earned had not been calculated or paid for the last quarter of fiscal year 2001, or for fiscal year 2002. Amounts were estimated based on the administrative incentives the contractor earned in 1999 and 2000.

Source: Auditor General staff analysis of the *State of Arizona Appropriations Report* and various reports of the Arizona Department of Economic Security Financial Management Control System for the years ended June 30, 2000 and 2001; and DES estimates of financial activity for the year ending June 30, 2002, as of November 30, 2001.

in January 2002. The first study, entitled “*Evaluation of the Arizona Works Pilot Program—Process Study Interim Report*,” was issued in January 2001. It evaluated the implementation of the pilot program from April 1, 1999 through June 30, 2000. It addressed five major topics, including: 1) planning and start-up activities; 2) organization and staffing; 3) intake and benefit determination; 4) employment, training, and support services; and 5) perceptions of staff, employers, and service providers. Overall, the study indicated that the contractor had successfully implemented the pilot program.

The second study, entitled “*Evaluation of the Arizona Works Pilot Program—Impact Study Interim Report*,” was issued in February 2001. It evaluated the performance of the pilot program compared with the DES-administered EMPOWER Redesign program. The study compared a large number of participants enrolled in each program. The study determined that there were no significant differences between the pilot program and EMPOWER Redesign in increasing earned income or reducing reliance on assistance.

### **Scope, Limitations, and Methodology**

This audit focused primarily on two areas—the extent of administrative cost savings under the pilot program and the impact of poor contractor recordkeeping as identified by DES. This focus was chosen to avoid replicating previous pilot program performance evaluations. This audit includes findings and recommendations as follows:

- The pilot program has not met its goal of reducing administrative costs (see Finding I, pages 11 through 16); and
- The need for additional Board oversight of contractor recordkeeping (see Finding II, pages 17 through 20).

This report also includes an Other Pertinent Information section (see pages 21 through 22) that provides information regarding the delay in implementing Phase II of the Arizona Works pilot program.

*Baseline cost estimate inadequately documented.*

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Throughout the audit, Auditor General staff encountered a number of limitations in determining how the baseline cost estimate was established. Key DES staff who had assisted in developing the original baseline cost estimate were no longer at DES. Auditor General staff also encountered inadequate documentation of amounts used to calculate the baseline cost estimate, primarily the costs related to tasks retained by DES and caseload percentages. As a result, auditors were unable to verify all the amounts used in the original baseline cost estimate.

This audit used a variety of methods to study the issues addressed in the report. Specifically:

- **To determine whether pilot program costs and baseline cost estimates were appropriate**—auditors interviewed Board staff, DES staff, and JLBC staff; reviewed statutes, the pilot program contract, previous pilot program reviews, JLBC appropriations reports and budget development worksheets, DES funding plans, appropriations transfers, expenditure information, and financial reports from DES' Financial Management Control System; and reconciled contractor payments to the contract and contractor billings.
- **To determine the impact of contractor recordkeeping problems identified by DES**—auditors reviewed the pilot program contract, applicable federal laws and regulations, and policies and procedures for DES' Office of Audit and Management Services; interviewed DES internal audit staff; evaluated the competence and objectivity of the internal audit work; and examined internal audit reports and working papers.
- **To determine the status of Phase II of the Arizona Works pilot program**—auditors reviewed Board meeting minutes and the proposed contract amendments, and interviewed DES and Board staff.

The Auditor General and staff express appreciation to the members of the Arizona Works Agency Procurement Board, JLBC staff, and DES staff for their assistance and cooperation throughout the audit.

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## FINDING I

# PILOT PROGRAM HAS NOT MET GOAL OF REDUCING ADMINISTRATIVE COSTS

The pilot program has cost more to operate each year than the estimated cost to operate EMPOWER Redesign. This happened because contractor payments were not sufficiently reduced to reflect federal decisions that impacted the pilot program's scope and operation. Beyond the amount paid to the contractor, DES is also incurring administrative costs and continues to service clients in the pilot area. If the pilot program is continued, the payment calculations should be changed to ensure the pilot program can meet its cost savings goal.

### Because Payment Formulas Not Adjusted, Pilot Program Costs Exceed DES' Estimated Costs

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*Not adjusting payment formulas for federal decisions caused the program to not reach savings requirement.*

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Although the pilot program was required to cut administrative costs by at least 10 percent compared to DES' EMPOWER Redesign program, it has been more costly. For example, in fiscal year 2001, the pilot program cost over 34 percent more than the estimated cost to operate EMPOWER Redesign due to payment formulas that did not reflect federal decisions that reduced the contractor's scope of work.

***Pilot program has cost more***—By statute, the pilot program's operating expenses must be at least 10 percent less than what DES' estimated operating costs (baseline cost estimate) would be in carrying out the EMPOWER Redesign program in the pilot area. The amount of the contractor's bid was about 80 percent of DES' estimated administrative cost. Under the contract, this was the contractor's guaranteed payment. However, the contract contained a provision allowing the contractor to receive incentive payments for meeting established performance measures, such

as exceeding EMPOWER Redesign job placements by 30 percent. After the first year, this incentive payment could raise the total contract payment to no more than 90 percent of DES' estimated administrative costs.

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*2001 contract payments exceeded estimated DES costs by \$1.4 million.*

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The pilot program did not meet its savings goal. As shown in Table 2 (see page 13), in each year of operation, the pilot program cost more than DES' estimated cost to operate EMPOWER Redesign. For example, in fiscal year 2001, the pilot program cost \$1.4 million more than DES' estimated costs.

***Savings goal exceeded because payment formulas not adjusted to reflect federal decisions***—The failure to meet the mandated savings was primarily the result of the contract payment formulas not being changed to reflect two decisions made by the federal government. Specifically,

- **Administrative incentive payments not reduced to reflect narrowed contract scope**—The incentive payment formula was not amended to reflect the contractor's reduced scope of work. As noted previously, under the proposal for the pilot program, the contractor was to perform eligibility and benefit assessments for TANF, childcare assistance for TANF-eligible clients, state-funded general assistance, Food Stamps, and AHCCCS. However, the federal government denied Arizona's request to allow a private contractor to determine eligibility and benefits for Food Stamps and AHCCCS. The contractor then contracted back with DES to conduct these functions and the contractor's guaranteed payment was reduced accordingly. However, the incentive payment was not similarly reduced. Although our legal analysis found that the incentive payment formula could have been revised, the Board did not change the incentive payment formula. Not changing the formula, however, contributed to the program's failure to achieve the mandated 10 percent savings. For example, the incentive payment in 2000 was over \$1,076,000. If the incentive payment formula had been adjusted to reflect the exclusion of the Food Stamps and AHCCCS functions it would have been approximately \$500,000.

**Table 2**

**Arizona Works Pilot Program  
Comparison of Contract Payments vs. Estimated  
Department of Economic Security Costs  
Years Ended or Ending June 30, 1999 through 2002**

	1999 <sup>1</sup>	2000	2001	2002 <sup>2</sup>
Contract payment to MAXIMUS, Inc.:				
Guaranteed administrative payments	\$1,114,530	\$4,600,695	\$4,624,368	\$3,152,700
Incentive payments for administrative savings <sup>3</sup>	490,985	1,076,493	1,111,000	1,508,600
Total contractor payments	<u>1,605,515</u>	<u>5,677,188</u>	<u>5,735,368</u>	<u>4,661,300</u>
Estimated cost for DES to administer the program <sup>4</sup>	<u>1,520,000</u>	<u>4,129,300</u>	<u>4,283,600</u>	<u>4,359,700</u>
Payments greater than estimated cost <sup>5</sup>	<u>\$ 85,515</u>	<u>\$1,547,888</u>	<u>\$1,451,768</u>	<u>\$ 301,600</u>
Percentage of payments more than estimated cost	6%	37%	34%	7%

<sup>1</sup> The pilot program began on April 1, 1999, and operated for only 3 months in fiscal year 1999.

<sup>2</sup> The significant decreases in contractor payments, payments greater than estimated costs, and percentage of payments more than estimated costs are caused by the contract's recognition of the change in cost allocation procedure required by the federal government.

<sup>3</sup> As of November 30, 2001, administrative incentives earned had not been calculated or paid for the last quarter of fiscal year 2001, or for fiscal year 2002. Amounts were estimated based on the administrative incentives the contractor earned in 1999 and 2000.

<sup>4</sup> Consists of estimates associated with activities performed by the contractor for TANF, childcare assistance for TANF-eligible clients, and state-funded general assistance. The estimate does not include DES' costs to administer the Food Stamp and AHCCCS programs in the pilot area.

<sup>5</sup> The contractor payments greater than DES estimated costs for 2000 and 2001 would have been lower if the contract had been modified for the change in cost allocation procedure and denial of Arizona's waiver request.

Source: Auditor General staff analysis of the pilot program contract and supporting baseline cost estimates of the Arizona Department of Economic Security for the years ended or ending June 30, 1999 through 2002; contractor payments recorded on the Arizona Department of Economic Security Financial Management Control System for the years ended June 30, 1999 through 2001; and DES estimates for the year ending June 30, 2002, as of November 30, 2001.

- **Payments not reduced to reflect shift in cost allocation—** Before the pilot program began, DES followed a practice of charging caseworker salaries to TANF, although these caseworkers may have administered other federal programs, including Food Stamps and AHCCCS. While the former Aid to Families with Dependent Children (AFDC) program allowed such an exception, the TANF legislation that replaced AFDC did not. Federal regulations require that costs be allocated to all benefiting programs based on the relative benefits derived by each program. Enforcing this requirement, which began in fiscal year 2000, reduced administrative costs that could be charged to the pilot program. This is because a portion of these costs now had to be allocated to Food Stamps and AHCCCS, functions that the federal government would not allow a private contractor to administer. Although the contract payment formulas should have been reduced to reflect this change, no changes were made in contract years 2000 and 2001. DES unsuccessfully attempted to negotiate an amendment to the 2001 contract to correct this error. There was such an amendment to the 2002 contract.

### **DES Has Additional Costs and Administrative Overlap**

There are further costs and inefficiencies related to the pilot program in addition to the payment issues described previously. DES bears additional costs in support and oversight associated with the pilot program contract and the Board. Further, because DES had to retain some of the administrative duties for clients being served under the pilot program, there are continued administrative costs and inefficiencies.

***DES has additional administrative costs related to the pilot program—***DES has additional responsibilities and incurs costs associated with the pilot program. These costs could not be fully quantified and were not considered in the preceding cost comparison. For example, DES must perform contract administration tasks such as assisting JLBC staff in developing contract baseline cost estimates, contract negotiation, and contract monitoring. Further, as of July 2001, DES assumed administrative support responsibilities for the Board. A private contractor had previ-

ously provided the Board administrative support for approximately \$300,000 per year. DES has received no funding to perform these duties.

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*Administrative overlap causes additional costs, inefficiencies, and duplication of effort.*

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***DES continues to serve pilot program clients***—Although the pilot program was intended to replace DES in the pilot area, the federal decision to not allow the contractor to conduct Food Stamp and AHCCCS eligibility and benefit assessments has resulted in a continuing DES presence. Both DES and contractor staff must work with the same clients, which results in inefficiencies and some duplication of effort. For example, clients who are eligible for TANF and Food Stamps must meet with both the contractor's staff and DES staff, in many cases providing the same information, rather than working with just one caseworker as the pilot program originally intended.

### **Additional Payment Formula Issues Also Need To Be Addressed**

If the pilot program is continued beyond December 2002, the Board and DES also need to take several payment formula concerns into account in addition to addressing the major formula errors discussed earlier. Specifically:

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*Baseline cost estimates should:*

- *Use current information;*
  - *Reflect caseload changes; and*
  - *Be documented.*
- 

- **Contract was not amended to include timely cost estimates**—The contract has not been amended to reflect up-to-date cost estimates. For the fiscal year 2001 contract, DES prepared a revised baseline cost estimate but was unable to come to an agreement with the contractor. As a result, the fiscal year 2001 contract was based on the original fiscal year 1999 baseline cost estimate. Although the fiscal year 2002 contract was based on more recent cost estimates, DES used fiscal year 2001 appropriations and fiscal year 2000 expenditures rather than more current amounts that were available. Baseline cost estimates should be revised each year using the most recent budget and expenditure information available. Further, because the JLBC had to approve the original baseline cost estimates, the Board should consider presenting its revisions to those estimates to JLBC for its approval.

- **Caseload changes not addressed in contractor payment**—Although current client caseload has not fluctuated significantly from the original client caseload, the current funding approach does not adjust the baseline cost estimates to reflect changes in the number of clients being served. If the caseload were to rise, the contractor’s payment would not increase to cover the additional clients. Conversely, if the caseload were to drop, the contractor is in effect paid for clients who are no longer receiving services. The baseline cost estimates should account for changes in caseload.
  
- **Baseline cost estimate methodology not documented**—The methodology used to determine the baseline cost estimates has not been adequately documented. This methodology has been the foundation for the original contract and all subsequent contract amendments. Although JLBC approved the baseline cost estimate in August 1998, there was not always written documentation of the methods used and decisions made to derive the estimate. Further, in some instances, records were not kept to support the actual amounts used to calculate the estimate. Inadequate documentation prevents appropriate external review and analysis of the baseline cost estimate. The Board should maintain better documentation of the methodology and amounts used in any future baseline cost estimates to help overcome these problems.

## **Recommendations**

1. If the Legislature decides that the pilot program should be continued, the Board should revise payment formulas to reflect the effect of federal decisions on the pilot program’s scope and costs.
  
2. If the pilot program continues, the Board should:
  - a. Amend contracts annually to reflect current baseline cost estimates;
  - b. Include caseload changes in the baseline cost estimate; and
  - c. Appropriately document the methodology and amounts used in future baseline cost estimates.

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## FINDING II

# CONTRACTOR PERFORMANCE COULD BE DIFFICULT TO MEASURE DUE TO RECORDKEEPING PROBLEMS DES IDENTIFIED

DES reviews of contractor records identified problems that may limit the ability to measure contractor performance. DES has conducted two contract compliance reviews and determined the contractor lacked sufficient records. Incomplete records could potentially result in the contractor receiving inappropriate performance incentive payments. Incomplete records also provide no assurance that clients are receiving appropriate services or are receiving cash benefits appropriately. Additional Board oversight is needed to address these problems.

### DES Identified Problems with Contractor Records

As required by federal laws and regulations, and as part of its contract oversight responsibilities, DES conducted two contract-monitoring reviews. The reviews identified substantial concerns with the contractor's client employment records. The contractor must maintain records regarding client employment and job training activities. These records are needed to be able to document compliance with federal laws and regulations governing public assistance programs. The records also serve as a basis for demonstrating client compliance with program requirements as well as documenting the contractor's efforts toward meeting its performance targets. The contractor maintains its own client files, but also enters the data into the DES computer system.

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*DES reviews found that contractor records were incomplete.*

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The first DES review was issued in August 2000. The contractor's response to the review listed the actions it had taken, or planned to take, to correct the deficiencies. However, the second review,

issued in May 2001, identified many of the same issues. The contractor's response to the second review did not list specific actions that it would take, but instead referred to its existing policies and procedures governing the issue areas.

The DES reviews found that there was not always documentation in the contractor's client files to support the information the contractor had recorded in the DES computer system. For example, if the computer records indicated the client was employed, there should be documents in the client's file to confirm the employment. Without the necessary documents, it is impossible to verify the accuracy of the computer records. DES identified many instances when client files lacked the necessary documents to support data in the computer system. In addition, the DES reviews also found instances where the computer records were incomplete.

### **Negative Impacts Can Result from Poor Recordkeeping**

Inaccurate or incomplete records lessen the likelihood that the pilot program's performance can be assessed reliably. This can potentially have a number of negative consequences. Specifically:

- **Performance incentive payments may not be appropriate**—If contractor records are insufficient, there is no way to confirm the accuracy of the data used to determine performance incentive payments. The contractor can receive incentive payments if it meets any of the performance criteria relating to client work participation. Performance goals are determined using data from DES' computer records and the contractor's files. Therefore, if the information is wrong, the contractor can be inappropriately rewarded.
- **Clients may not be receiving appropriate services**—If contractor records are incomplete or inaccurate, there is no proof that clients are receiving intended services or being sanctioned when required. For example, clients may not be

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*Poor records can result in improper payments and services.*

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receiving needed job training. Further, if clients are not fulfilling their work participation requirements, the State may be inappropriately paying benefits to clients who should be sanctioned.

**Additional Oversight  
Needed**

Additional contract oversight should help ensure that the program can document that it is in compliance with federal requirements, that the contractor is appropriately compensated, and that clients receive appropriate services or are sanctioned when required. DES should continue to conduct contract monitoring reviews to identify any deficiencies and discrepancies in contractor records. As part of its reviews, DES should determine whether the records provide sufficient support for providing the contractor incentive payments. Finally, DES should inform the Board of the results of its reviews in a timely manner. DES did not provide the Board with information on its monitoring reviews until the Board's December 2001 meeting.

For its part, the Board should require the contractor to develop and implement a corrective action plan to address the DES findings. The Board should also amend its contract to include penalties for failure to maintain accurate and sufficient documentation.

## **Recommendations**

1. DES should continue regular monitoring of the contractor to ensure appropriate documentation is kept, and report the results of its reviews to the Board in a timely manner.
2. As part of its monitoring reviews DES should determine whether the contractor has kept sufficient records to support incentive payments for meeting contract performance measures.
3. The Board should require the contractor to develop and implement corrective actions plans to address the problems identified in the DES reviews.
4. The Board should amend the contract to include penalties for the contractor's failure to maintain accurate and sufficient information.

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## OTHER PERTINENT INFORMATION

During this audit, information was obtained about the status of Phase II of the pilot program.

### **Board Has Experienced Delays in Phase II Implementation**

Although the Arizona Works enabling legislation called for a second phase of the pilot program to be in place by April 1, 2001, Phase II has not yet been implemented. A site was selected in time to meet this requirement; however, conflicts over contract cost negotiations delayed implementation. As a result, the Board has had to restart the site selection process.

***Statute required Phase II implementation by 2001***—A.R.S. §46-343 required that the Board select a second pilot site in a rural area for the third and fourth year of the pilot program beginning January 1, 2001, and allowed for a 3-month implementation period. The Board held open meetings in prospective counties in March 2000. The counties considered at that time were Mohave, Pinal, and Cochise. In June 2000, the Board selected Mohave County as the site for implementation of Phase II.

***Cost issues delayed implementation***—Phase II implementation was delayed due to conflicts over costs. After the Board selected Mohave County, a baseline cost estimate was developed for administering the pilot program in Mohave County beginning January 2001. However, the contractor rejected the proposed estimate due to compensation issues.<sup>1</sup> DES continued to negotiate with the contractor for the next 10 months over the proposed baseline cost estimate and presented an amendment to the contractor for Phase II in June 2001. At the July 2001 Board meeting, the contractor accepted the amendment for Mohave County.

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<sup>1</sup> Phase II of the pilot program was awarded to MAXIMUS, Inc. as part of the Phase I contract.

## ***Other Pertinent Information***

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However, the Board voted against the amendment for the following reasons:

1. JLBC had not officially approved the Mohave County baseline cost estimate as required by statute.
2. There had not been an evaluation of Phase I by JLBC as required by statute.
3. The remaining time frame to implement the pilot in Mohave County created transition issues for clients and providers and did not provide adequate time for the statutorily required evaluation.

***New Phase II site selected***—Due to its concerns caused by the delays in attempting to implement Phase II, in October 2001 the Board reversed its prior decision to select Mohave County. The Board restarted its site selection process and appointed a committee to look at alternative rural counties and make a site recommendation. In December 2001, the Board selected Greenlee County as the Phase II site.

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## Agency Response

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Arizona Works Agency Procurement Board

Jane Dee Hull  
Governor

Hank Atha  
Chairman

January 22, 2002

Ms. Debbie Davenport, CPA  
Office of the Auditor General  
2910 North 44<sup>th</sup> Street, Suite 410  
Phoenix, AZ 85018

Dear Ms. Davenport:

The Arizona Works Agency Procurement Board (Board) wishes to thank the Office of the Auditor General for the opportunity to respond to the recently completed audit of the Arizona Works pilot program.

The Board met on December 19, 2001 and January 9, 2002 to review the report and discuss the findings and recommendations. The Board responded to each of the recommendations under Finding #1, but the Board was not able to agree on a response to this finding. This was due, in large part, because the Joint Legislative Budget Committee has not updated the baseline and administrative costs for the pilot program. In addition, the Board believes that it does not have the authority to act on several of the recommendations, which should be referred to the Legislature. Enclosed is a copy of the Board's response to the report.

If you wish to discuss this further, please call me at (520)740-5205.

Sincerely,

A handwritten signature in black ink, appearing to read "Hank Atha".

Hank Atha  
Chair

Enclosure



Arizona Works Agency Procurement Board

Jane Dee Hull  
Governor

Hank Atha  
Chairman

*Note: Board responses appear in italics*

**FINDING I - PILOT PROGRAM HAS NOT MET GOAL OF REDUCING ADMINISTRATIVE COSTS**

*The Arizona Works Agency Procurement Board (Board) is not able to come to agreement on this finding.*

**Recommendations**

1. If the Legislature decides that the pilot program should be continued, the Board should revise payment formulas to reflect the effect of federal decisions on the pilot program's scope and costs.

*The Board does not believe it has the authority to implement this recommendation. The recommendation should be referred to the Legislature.*

2. If the pilot program continues, the Board should:
  - a. Amend contracts annually to reflect current baseline cost estimates;
  - b. Include caseload changes in the baseline cost estimate; and
  - c. Appropriately document the methodology and amounts used in future baseline cost estimates.

*The Board believes it is and has been operating under the terms of the current legislation and it does not have the authority to make these changes. The Board will request the Department of Economic Security (DES) and the Joint Legislative Budget Committee (JLBC) to appropriately document the methodology and amounts used in future baseline cost estimates.*

**FINDING II - CONTRACTOR PERFORMANCE COULD BE DIFFICULT TO MEASURE DUE TO RECORDKEEPING PROBLEMS DES IDENTIFIED**

*The Board agrees with the finding and the following recommendations will be implemented.*

**Recommendations**

1. DES should continue regular monitoring of the contractor to ensure appropriate documentation is kept, and report the results of its reviews to the Board in a timely manner.

*The Board agrees with the recommendation. DES has assured the Board that it will continue regular monitoring, and that results will be reported to the Board timely.*

2. As part of its monitoring reviews DES should determine whether the contractor has kept sufficient records to support incentive payments for meeting contract performance measures.

*DES has assured the Board that it will continue to require the contractor to keep sufficient records, and that the Board will be kept apprised of reviews.*

3. The Board should require the contractor to develop and implement corrective actions plans to address the problems identified in the DES reviews.

*The Board will request the contractor and DES to work together to develop and implement corrective action plans to address the problems identified in reviews.*

4. The Board should amend the contract to include penalties for the contractor's failure to maintain accurate and sufficient information.

*The Board does not believe it has the authority, unilaterally, to amend the contract to assess such penalties.*

## Other Performance Audit Reports Issued Within the Last 12 Months

<p>01-1 Department of Economic Security— Child Support Enforcement</p> <p>01-2 Department of Economic Security— Healthy Families Program</p> <p>01-3 Arizona Department of Public Safety—Drug Abuse Resistance Education (D.A.R.E.) Program</p> <p>01-4 Arizona Department of Corrections—Human Resources Management</p> <p>01-5 Arizona Department of Public Safety—Telecommunications Bureau</p> <p>01-6 Board of Osteopathic Examiners in Medicine and Surgery</p> <p>01-7 Arizona Department of Corrections—Support Services</p> <p>01-8 Arizona Game and Fish Commission and Department—Wildlife Management Program</p> <p>01-9 Arizona Game and Fish Commission—Heritage Fund</p> <p>01-10 Department of Public Safety— Licensing Bureau</p> <p>01-11 Arizona Commission on the Arts</p> <p>01-12 Board of Chiropractic Examiners</p> <p>01-13 Arizona Department of Corrections—Private Prisons</p> <p>01-14 Arizona Automobile Theft Authority</p> <p>01-15 Department of Real Estate</p> <p>01-16 Department of Veterans' Services Arizona State Veteran Home, Veterans' Conservatorship/ Guardianship Program, and Veterans' Services Program</p>	<p>01-17 Arizona Board of Dispensing Opticians</p> <p>01-18 Arizona Department of Correct- ions—Administrative Services and Information Technology</p> <p>01-19 Arizona Department of Education— Early Childhood Block Grant</p> <p>01-20 Department of Public Safety— Highway Patrol</p> <p>01-21 Board of Nursing</p> <p>01-22 Department of Public Safety— Criminal Investigations Division</p> <p>01-23 Department of Building and Fire Safety</p> <p>01-24 Arizona Veterans' Service Advisory Commission</p> <p>01-25 Department of Corrections— Arizona Correctional Industries</p> <p>01-26 Department of Corrections— Sunset Factors</p> <p>01-27 Board of Regents</p> <p>01-28 Department of Public Safety— Criminal Information Services Bureau, Access Integrity Unit, and Fingerprint Identification Bureau</p> <p>01-29 Department of Public Safety— Sunset Factors</p> <p>01-30 Family Builders Program</p> <p>01-31 Perinatal Substance Abuse Pilot Program</p> <p>01-32 Homeless Youth Intervention Program Letter Report: Department of Environmental Quality—Fiduciary</p> <p>01-33 Department of Health Services— Behavioral Health Services Reporting Requirements</p>
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## Future Performance Audit Reports

Kinship Foster Care