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December 21, 2016

The Honorable John Allen, Chair
Joint Legislative Audit Committee

The Honorable Judy Burges, Vice Chair
Joint Legislative Audit Committee

Dear Representative Allen and Senator Burges:

Our Office has recently completed a 24-month followup of the *Arizona Office of Administrative Hearings* regarding the implementation status of the 16 audit recommendations (including sub-parts of the recommendations) presented in the performance audit report released in September 2014 (Auditor General Report No. 14-104). As the attached grid indicates:

- 11 have been implemented;
- 2 have been partially implemented;
- 2 are in the process of being implemented; and
- 1 is no longer applicable.

Unless otherwise directed by the Joint Legislative Audit Committee, this concludes our followup work on the Arizona Office of Administrative Hearing's efforts to implement the recommendations from the September 2014 performance audit report.

Sincerely,

Dale Chapman, Director
Performance Audit Division

DC:ka
Attachment

cc: Gregory Hanchett, Interim Director
Arizona Office of Administrative Hearings

Arizona Office of Administrative Hearings

Auditor General Report No. 14-104

24-Month Follow-Up Report

Recommendation	Status/Additional Explanation
Finding 1: Office should enhance controls for ensuring fair, independent, and timely hearings	
<p>1.1 To further enhance its policies and procedures for ensuring that it provides fair and independent hearings, the Office should:</p> <p>a. Develop and implement written policies and procedures for:</p> <ul style="list-style-type: none"> • Periodically analyzing agencies' responses to hearing decisions to identify trends in judge error or bias that might warrant further review and/or action; • Providing additional guidance on judges' ethical behavior to include conflicts of interest, participation in outside activities, and other activities the NAALJ model code of ethics covers that are relevant to the Office's judges; and • All informal procedures it has established, such as informing hearing participants that they have the right to appeal a decision. <p>b. Add evaluation questions relating to decision fairness, clarity, and timeliness; review the timing of when it solicits evaluation feedback; and consider developing an electronic evaluation that either supplements or replaces the paper evaluation.</p>	<p>Implemented at 12 months</p> <p>Implemented at 12 months</p>
<p>1.2 To comply with A.R.S. §41-1092.01, the Office should develop and implement formal training programs for agencies and its judges. These training programs should:</p> <p>a. Include topics related to ensuring fair and independent hearings;</p> <p>b. Include policies for judge training that specify minimum training requirements, guidelines for appropriate training received from outside sources, and procedures for ensuring that judges receive the required training; and</p> <p>c. Identify potential training topics for judges based on information obtained through some of its oversight and feedback procedures, such as supervisory review of judges, external feedback on the Office's performance, and review of agency responses to judges' decisions.</p>	<p>Implemented at 12 months</p> <p>Implemented at 12 months</p> <p>Implemented at 12 months</p>

Recommendation

Status/Additional Explanation

1.3 To ensure that it complies with statutory time frames for holding hearings, the Office should schedule hearings more than 60 days after the hearing request only when it receives documentation showing that all case parties have agreed to a later date, unless a party shows good cause for a postponement or in cases where it has held a prehearing conference, and it should make such decisions on a case-by-case basis. The Office should also use its case management system to track cases that exceed the 60-day requirement and the reasons for the exceedances. Additionally, in order to ensure that nonagency parties do not face undue or unfair burdens, the Office should pay particular attention to meeting the 60-day requirement in cases involving appealable agency actions.

Implemented at 12 months

Finding 2: Office should align rate-setting method with best practices

2.1 To further align its rate-setting method with best practices, the Office should develop and implement a cost-based rate-setting method that sets rates for at least 1 year at a time. In developing the method, the Office should:

- a. Examine the appropriate allocation of direct and indirect costs to its rates;
- b. Develop rates using average costs;

Implemented at 12 months

Partially implemented in a different manner at 24 months

The Office has continued its practice of calculating monthly rates for its services to generate sufficient cash to pay its monthly expenditures regardless of caseload fluctuations. However, at the end of fiscal year 2016, the Office calculated annual average rates for its hearing services based on its caseload during that fiscal year and used these average rates to recalculate the amounts due from each state agency for services provided during fiscal year 2016. The Office then either refunded or billed these state agencies for the difference between their actual payments made during the fiscal year and the recalculated amount due. As a result of these adjustments, the state agencies paid equitable rates for hearing services provided in fiscal year 2016. The Office reported that it did not recalculate the amounts due from local governments because it cannot provide refunds to or bill local governments in the time allotted to reconcile any amounts owed based on the services provided at the end of the fiscal year.

Recommendation

Status/Additional Explanation

- c. Set its rates high enough to generate sufficient revenues during periods of high demand to build up enough cash reserves to covers its expenditures during periods of low demand; and

No longer applicable

Because the Office has continued its practice of calculating monthly rates for services to generate sufficient cash to pay its monthly expenditures regardless of caseload fluctuations, and has instead calculated annual average rates for its hearing services at the end of the fiscal year which it uses to either provide refunds to or rebill state agencies, this recommendation is no longer applicable (see explanation for Recommendation 2.1b).

- d. Continue seeking to reduce costs as much as possible.

Implemented at 24 months

- 2.2 To ensure a consistent rate-setting method, the Office should develop and implement formal, written rate-setting policies and procedures that include a requirement and procedures for the periodic review of rates. Additionally, when developing these policies and procedures, the Office should solicit input from agencies and publicize its policies, procedures, and rates on its Web site.

Partially implemented at 24 months

The Office has included an explanation of its revised method for calculating the rates for its hearing services on its website and in its interagency service agreements (agreements) with billed agencies, including its practice of calculating annual average rates for its hearing services at the end of each fiscal year (see explanation for Recommendation 2.1b). However, the Office has not developed written rate-setting procedures and reported that it does not plan to do so. Further, it did not solicit input from agencies when developing the revised method, but reported that agencies can review the method before entering an agreement for hearing services.

- 2.3 To address the State General Fund appropriation shortfall, the Office should:

- a. Develop and implement written policies and procedures to periodically review the funding status of agencies. The Office should design its policies and procedures to allow it to identify any agencies it has been treating as State General Fund-supported agencies that may no longer receive State General Fund support and to negotiate inter-agency service agreements with them if it determines it has the authority to do so;

Implemented at 12 months

- b. Once it has implemented a cost-based rate-setting method and can more accurately quantify the cost of services it provides to agencies the State General Fund supports, work with the Legislature to clarify how the Office should make up any continued shortfall between its State General Fund appropriation and the cost of services it provides to agencies the State General Fund supports; and

Implemented at 24 months

Recommendation**Status/Additional Explanation**

- c. Work with the Arizona Department of Fire, Building and Life Safety to ensure that its fee for condominium and planned community association hearings is sufficient to cover the cost of services the Office bills, or work with the Legislature to change the way the fee for these hearings is determined.

Implementation in process

According to the Office, prior to fiscal year 2017, it worked with the Arizona Department of Fire Building and Life Safety (DFBLS) to increase the fee for condominium and planned community association hearings to a level that was sufficient to cover the cost of the services the Office provided. However, Laws 2016, Ch. 128, discontinued the DFBLS and transferred responsibility for handling condominium and planned community association disputes to the Arizona Department of Real Estate (Department). After it assumed responsibility for these disputes, the Department reduced the fee for condominium and planned community association hearings to a level that the Office reported is not sufficient to cover its costs. The Office reported that it is working with the Department to increase the fee for condominium and planned community association hearings. In addition, the Office reported that it plans to continue looking for methods of streamlining the condominium and planned community association hearing process to reduce its hearing costs, such as implementing a mediation process.

Sunset Factor #2: The extent to which the Office has met its statutory objective and purpose and the efficiency with which it has operated.

1. The Office should continue implementing its revised cash-handling and disbursement procedures and its new policy for employee use of purchasing cards.

Implementation in process

The Office has developed and implemented policies and procedures for cash-handling and disbursement and employee use of purchasing cards. In addition, it updated these policies and procedures after the State implemented a new accounting system in August 2015. However, the Office reported that it is still in the process of developing a procedure for the supervisory review of expenditures and plans to finalize this procedure in January 2017.

2. The Office should develop and implement policies and procedures to guide its procurement activities to help ensure these activities comply with procurement laws and regulations.

Implemented at 24 months