



A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Performance Audit

Arizona Department of Administration—Arizona State Purchasing Cooperative Program

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Debra K. Davenport
Auditor General

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November 10, 2014

Members of the Arizona Legislature

The Honorable Janice K. Brewer, Governor

Kathleen M. Peckardt, Interim Director
Arizona Department of Administration

Transmitted herewith is a report of the Auditor General, *A Performance Audit of the Arizona Department of Administration—Arizona State Purchasing Cooperative Program*. This report is in response to an October 3, 2013, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting within 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 Department of Administration agrees with all of the findings and plans to implement all of the recommendations.

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

Sincerely,

Debbie Davenport
Auditor General

Attachment

REPORT HIGHLIGHTS
PERFORMANCE AUDIT

Our Conclusion

The Arizona Department of Administration (Department) administers a purchasing cooperative program that allows members to purchase goods and services from state-wide contracts. Statute authorizes the Department to establish a program fee that covers the costs of administering the purchasing cooperative program. However, the program's fee revenue has exceeded the program's administrative costs. Not only has the Department used program fee revenue to administer the purchasing cooperative program, it has also used this revenue to pay for most of the cost of the state electronic procurement system, ProcureAZ, and to pay the salaries and benefits of more than half of the Department's procurement staff. Therefore, the Department needs to better align the program fee with program costs. In addition, the Department needs to improve the collection of program fee revenue and continue to strengthen its cash-handling controls over the processing of program fee revenue.



2014

Program fee revenue exceeds costs and is misapplied

Department administers state purchasing cooperative—The Department established a purchasing cooperative program in 1984 that allows members to purchase goods and services from state-wide contracts. As of July 2014, 957 state-wide contracts were available to purchasing cooperative members. The advantages of purchasing through the cooperative program include volume discounts, guaranteed pricing, and a reduction in administrative costs. Members include Arizona political subdivisions, nonprofit organizations, the federal government, and tribal nations. State agencies also use state-wide contracts, but are not purchasing cooperative members. Between fiscal years 2012 and 2014, purchasing cooperative members purchased at least \$1 billion in goods and services through the state-wide contracts.

To cover the Department's cost of administering the purchasing cooperative program, state-wide contract vendors are required to remit to the Department on a quarterly basis a 1 percent program fee based on the dollar value of sales to purchasing cooperative members. This fee applies to all state-wide contract vendors unless defined differently in the contracts. In fiscal years 2013 and 2014, the Department collected more than \$3.2 and \$3.7 million in program fee revenue, respectively.

Program fee revenue has exceeded program's costs and used for other procurement costs—Statute authorizes the Department to establish a program fee to cover the cost of administering the purchasing cooperative program, but in fiscal years 2013 and 2014, program fee revenue exceeded purchasing cooperative program costs by approximately \$987,000 and \$1.3 million, respectively. This resulted in a fiscal year 2014 year-end fund balance of nearly \$3.4 million.

The Department has used program fee revenue to pay for some nonpurchasing cooperative program costs. For example:

- Although the Department used program fee revenue to pay the salaries and related benefit costs for more than half of its 38 procurement positions, it had not conducted any type of cost analysis to determine how many of its procurement positions program fee revenue should support. Additionally, even though the Department's state-wide contracts and ProcureAZ functions primarily support state agencies, the Department used program fee revenue to pay for 86 percent of procurement personnel costs related to these functions.
- The Department also used program fee revenue to pay for \$7.4 million of the \$8.6 million spent to purchase, implement, manage, and maintain ProcureAZ between fiscal years 2008 and 2014. However, only 17 percent of the active contracts on ProcureAZ as of July 2014 were available for purchasing cooperative members' use.

Therefore, the Department should take steps to evaluate the purchasing cooperative program's costs and better align the program fee with these costs.

Recommendation

The Department should implement a structured approach to evaluate purchasing cooperative program costs and establish a program fee that is consistent with these costs.

Department needs to improve collection of program fee revenue

Department cannot ensure that all state-wide contract vendors appropriately report and remit program fee revenue—The Department has not established adequate policies and practices for collecting program fee revenue from state-wide contract vendors. We reviewed 20 vendor files for the time period July 1, 2009 through December 31, 2013, and found improperly reported fee amounts and inadequate followup by the Department on late and missing fee payments. Specifically:

- 15 vendors did not submit required quarterly reports documenting sales to purchasing cooperative members and state agencies. One vendor did not provide any reports and it was subsequently determined that the vendor owed approximately \$1,700 in program fees.
- 5 vendors had outstanding program fee amounts due. For example, one vendor had \$109,309 in unpaid program fee monies, including \$21,354 that had been outstanding for nearly 2 years and \$64,074 that had been outstanding for more than a year prior to the vendor remitting payment in April 2014.
- 5 vendors had discrepancies between their reported sales amounts to state agencies and state accounting records. One of these vendors under-reported \$51.8 million in sales. Because it did not verify the sales amounts that this vendor reported, the Department did not collect at least \$323,000 and possibly as much as \$518,000 in program fee revenue.

Department should develop and implement various collections policies and procedures—These policies and procedures should address documenting and communicating contractually established program fee rates to the staff responsible for tracking collections, verifying vendor-reported sales and program fee amounts, following up on deficient or delinquent sales reports and program fee revenue payments, and the supervisory oversight of the Department's collections processes and practices.

Recommendations

The Department should:

- Pursue collecting unpaid program fee revenue and resolve discrepancies in reported sales amounts; and
- Develop and implement various program fee collections policies and procedures to help ensure that program fee amounts are appropriately remitted to the Department.

Department should continue to improve its controls over program fee collections

The Department should continue to strengthen its internal controls over the processing of program fee revenue. The Department lacked several cash-handling controls that the *State of Arizona Accounting Manual* requires and are important for reducing the risk of fraud, theft, and loss. Although the Department has begun taking steps to strengthen its controls, including moving all cash-handling responsibilities from the Department's procurement office to its accounting office, additional steps are needed. These include developing detailed cash-handling policies and procedures that address all cash-handling functions, including restrictively endorsing checks upon receipt, depositing checks daily, storing checks in a secure location before deposit, and segregating cash-handling duties.

Recommendation

The Department should develop and implement detailed cash-handling policies and procedures, and train staff on them.

TABLE OF CONTENTS



| | |
|--|-----|
| Introduction | 1 |
| Finding 1: Program fee revenue exceeds program costs and is misapplied | 5 |
| Program fee revenue exceeds program administrative costs and used inappropriately | 5 |
| Department should evaluate the purchasing cooperative program's costs and align the program's fee | 7 |
| Recommendations | 9 |
| Finding 2: Department needs to improve collection of program fee revenue | 11 |
| Department has not ensured that program fee revenue is properly reported and collected | 11 |
| Department should address collection deficiencies by developing and implementing various policies and procedures | 12 |
| Recommendations | 14 |
| Finding 3: Department should continue to improve its controls over program fee collections | 15 |
| Various internal control weaknesses identified | 15 |
| Department has begun taking steps to address internal control weaknesses, but additional action is needed | 16 |
| Recommendations | 17 |
| Appendix A: Methodology | a-1 |

TABLE OF CONTENTS



Agency Response

Tables

| | | |
|---|--|---|
| 1 | Schedule of revenues, expenditures, and changes in fund balance Fiscal years 2012 through 2014 (In thousands) (Unaudited) | 3 |
| 2 | Number of department procurement positions by funding source As of June 23, 2014 | 6 |

Figures

| | | |
|---|---|----|
| 1 | Mississippi PEER structured fee-setting process developed for state government | 8 |
| 2 | Number of days program fee payment checks held before being restrictively endorsed and deposited Fiscal year 2013 | 16 |

INTRODUCTION

Scope and Objectives

The Office of the Auditor General has conducted a performance audit of the Arizona Department of Administration (Department)—Arizona State Purchasing Cooperative Program (purchasing cooperative program), pursuant to an October 3, 2013, resolution of the Joint Legislative Audit Committee. This audit is the first in a series of audits conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq.

This audit reviewed and makes recommendations regarding several aspects of the purchasing cooperative program including the Department's establishment of the purchasing cooperative program fee (program fee), processes for collecting program fee revenue from vendors, and the Department's handling of program fee monies once they are received from the vendors. Future audits will focus on other aspects of the Department's operations, including the state procurement system and an analysis of the statutory sunset factors.

Department administers state purchasing cooperative program that allows members to purchase from state-wide contracts

The Department administers a purchasing cooperative program, established in 1984, that allows its members to purchase goods and services from state-wide contracts. Membership in the purchasing cooperative program is available to Arizona political subdivisions including cities, counties, and school districts. Membership is also available to nonprofit organizations, the federal government, and tribal nations, as stipulated in statutes.¹ Although state agencies also use state-wide contracts, they are not purchasing cooperative members.

As of July 1, 2014, members of the purchasing cooperative program could buy goods and services from 957 state-wide contracts (see textbox for examples of the types of goods and services that can be bought). Purchasing cooperative members receive several benefits by participating in the purchasing cooperative program including volume discounts, guaranteed pricing, administrative ease for contract users since the competitive bid process is complete, and reduction in and avoidance of administrative costs that would result from the contract users conducting their own procurements. According to department records, between fiscal years 2012 and 2014, purchasing cooperative members purchased at least \$1 billion in goods and services through state-wide contracts.²

To join the purchasing cooperative program, entities must sign a 5-year agreement with the Department, which specifies the conditions under which

Examples of goods and services available on state-wide contracts

Goods:

- Computers, printers, and servers
- Janitorial supplies
- Office furniture
- Vehicles

Services:

- Training and professional development
- Telecommunications carrier
- Drug and alcohol testing
- Temporary staffing

Source: Auditor General staff analysis of the Department's state-wide contract data.

¹ Nonprofit corporations include those designated by the Internal Revenue Service under sections 501(c)(3) through 501(c)(6) or under section 115, if created by two or more local public procurement units, and include certified nonprofit agencies that serve individuals with disabilities as defined in A.R.S. §41-2636.

² Purchases may be understated because department records had missing data related to some purchasing cooperative member purchases.

members may use state-wide contracts.¹ To cover the Department's cost of administering the purchasing cooperative program, state-wide contract vendors are required to remit to the Department on a quarterly basis a 1 percent program fee based on the dollar value of sales to purchasing cooperative members. This 1 percent program fee has been in effect since July 1, 2009, and applies to all vendors with state-wide contracts unless defined differently within the contracts.² This program fee applies only to payments actually received by the vendors and does not apply to goods and services ordered but not yet paid for by the customers. Prior to the implementation of the 1 percent program fee, purchasing cooperative members paid an annual fee. According to department records, the annual fee was \$160 in 1997, but gradually increased to \$1,045 in 2009.

Department procurement staffing and budget

The Department's Procurement Office (Office) administers the purchasing cooperative program. Staff from the Office's strategic contracting unit develop and administer the state-wide contracts, while the Office's systems support staff provide technical assistance on the electronic procurement system, called ProcureAZ, which serves as an online, publicly available official procurement record. Through ProcureAZ, purchasing cooperative members may view available state-wide contracts, access the State's vendor list, and post solicitations for goods and services. Office staff also track program fee revenue payments.

As shown in Table 1, page 3, in fiscal years 2013 and 2014, the Department collected more than \$3.2 and \$3.7 million in purchasing cooperative program fee revenue, respectively. In fiscal year 2014, the Department used the program fee revenue to pay approximately \$1.3 million for procurement personnel salaries and related benefit costs. In addition, according to a department official, approximately \$869,000 in program fee revenue was used for contracted services for the management and maintenance of ProcureAZ in fiscal year 2014.

¹ The Department's cooperative agreement for nonprofit entities specifies that the agreement will remain in effect unless canceled pursuant to A.R.S. §38-511 or the Department or nonprofit entity requests its termination.

² The program fee remitted to the Department based on sales to purchasing cooperative members does not include taxes or regulatory fees, any returns or credits, nor any shipping charges not already included in the vendor's unit prices.

**Table 1: Schedule of revenues, expenditures, and changes in fund balance
Fiscal years 2012 through 2014
(In thousands)
(Unaudited)**

| | 2012 | 2013 | 2014 |
|---|-------------------|-------------------|-------------------|
| Revenues | | | |
| Purchasing cooperative program fee ¹ | <u>\$ 3,522.3</u> | <u>\$ 3,236.8</u> | <u>\$ 3,767.2</u> |
| Expenditures and transfers | | | |
| Personal services and related benefits ² | 427.6 | 799.5 | 1,342.6 |
| Professional and outside services ³ | 1,013.8 | 463.8 | 227.1 |
| Travel | | 0.9 | 1.6 |
| Other operating | 1,133.4 | 755.1 | 762.1 |
| Equipment | 151.2 | 46.5 | 57.9 |
| Indirect costs ⁴ | | 49.0 | 49.7 |
| Total expenditures | <u>2,726.0</u> | <u>2,114.8</u> | <u>2,441.0</u> |
| Transfers ⁵ | <u>9.5</u> | <u>135.0</u> | <u>19.3</u> |
| Total expenditures and transfers | <u>2,735.5</u> | <u>2,249.8</u> | <u>2,460.3</u> |
| Excess of revenues over expenditures and transfers | 786.8 | 987.0 | 1,306.9 |
| Fund balance, beginning of year | <u>316.9</u> | <u>1,103.7</u> | <u>2,090.7</u> |
| Fund balance, end of year ⁶ | <u>\$ 1,103.7</u> | <u>\$ 2,090.7</u> | <u>\$ 3,397.6</u> |

¹ This program fee is 1 percent of quarterly sales transacted by purchasing cooperative members unless defined differently within a vendor's state-wide contract.

² According to the Department, amounts increased significantly between fiscal years 2012 and 2014 because statutorily required procurement reform led to increased staffing and the program fee revenues became more stable and reliable allowing for the funding of increased staffing.

³ According to the Department, amounts decreased significantly between fiscal years 2012 and 2014 primarily because ProcureAZ was still being implemented in fiscal year 2012 and, therefore, required the acquisition of professional and outside services. However, fewer professional and outside services were needed after ProcureAZ was completely implemented.

⁴ Amount consists of administrative and support services costs that are allocated by the Department to its various divisions.

⁵ The fiscal year 2012 amount primarily consisted of statutorily required transfers to the State General Fund to provide support for state agencies, and the fiscal year 2014 amount primarily consisted of transfers to the Automation Projects Fund for the replacement of the State's accounting system currently under development. In addition, according to the Department, the fiscal year 2013 amount consists of transfers to other department funds for services provided by the General Services Division for a one-time tenant improvement project to modify the Procurement Office facilities and to create a training room for procurement training.

⁶ According to the Department, the fund balance for the purchasing cooperative program has been strategically reserved to manage the linkage between ProcureAZ and the State's accounting system—the Arizona Financial Information System (AFIS)—and as a contingency for the link to the AFIS replacement currently under development. In addition, the fund balance provides a contingency fund for unforeseen vulnerabilities and sudden operational issues.

Source: Auditor General staff analysis of the AFIS *Accounting Event Transaction File* for fiscal years 2012 through 2014 and the AFIS Management Information System *Status of General Ledger-Trial Balance* screen for fiscal years 2013 and 2014.

FINDING 1

The Arizona Department of Administration's (Department) approach for establishing the Arizona State Purchasing Cooperative Program fee (program fee) needs to be improved. Arizona Revised Statutes (A.R.S.) §41-2632 authorizes the Department to establish a program fee that covers the costs of administering the Arizona State Purchasing Cooperative Program (purchasing cooperative program). However, the program's fee revenue exceeds the purchasing cooperative program's administrative costs. Program fee revenue has gone not only to administer the purchasing cooperative program, but also to pay for most of the cost of the state electronic procurement system, ProcureAZ, and to pay the salaries and benefits of more than half of the Department's procurement staff positions. As a result, the Department needs to implement a structured approach to setting the program fee, including steps to evaluate current purchasing cooperative program costs and better align its program fee with these costs.

Program fee revenue exceeds program costs and is misapplied

Program fee revenue exceeds program administrative costs and used inappropriately

Under its statutory authority to levy a program fee to cover its costs to administer the purchasing cooperative program, the Department generally requires state-wide contract vendors to remit to the Department on a quarterly basis a 1 percent program fee based on the dollar value of sales to purchasing cooperative members.¹ As shown in Table 1, page 3, program fee revenue amounts remitted by state-wide contract vendors to the Department totaled more than \$3.7 million in fiscal year 2014. However, the Department's program fee has resulted in more revenue than is needed to administer the purchasing cooperative program, and the Department has used this revenue to pay for some nonprogram expenses. Specifically:

- **Program fee revenue has exceeded purchasing cooperative program's costs**—A.R.S. §41-2632(A)(4) requires the Department to collect from purchasing cooperative members the direct and indirect costs of department personnel providing purchasing cooperative program services. In addition, A.R.S. §41-2632(A)(5) stipulates that the Department may request reimbursement from purchasing cooperative members for the reasonable and necessary costs of providing informational, technical, or other services or software that may assist in improving the efficiency or economy of procurement. However, as shown in Table 1, page 3, revenue generated by the purchasing cooperative program's 1 percent program fee has exceeded program costs by \$987,000 in fiscal year 2013 and approximately \$1.3 million in fiscal year 2014. This resulted in a fiscal year 2014 year-end fund balance for the purchasing cooperative program of nearly \$3.4 million.
- **Fee revenue used to pay for some nonpurchasing cooperative program costs**—The Department has used program fee revenue to pay for department costs that are not associated with the purchasing cooperative program. For example:
 - **Paying for procurement staff positions with little or no purchasing cooperative program-related responsibilities**—As shown in Table 2, page 6, for fiscal year 2014, the Department used program fee revenue to pay the salaries and related benefit costs for 55 percent

¹ Although the Department has generally established a 1 percent program fee based on sales to purchasing cooperative members, department procurement staff may modify the amount and/or applicability of the program fee on a contract-by-contract basis.

**Table 2: Number of department procurement positions by funding source
As of June 23, 2014**

| Organizational unit | Positions by funding source | |
|--|-----------------------------|----------------------------|
| | Cooperative fee | Other sources ¹ |
| Administrative: Staff provide management, training, compliance, analysis, and clerical support for state procurement personnel. | 2 | 5 |
| Shared services: Staff provide procurement services to department divisions and state agencies with limited delegated procurement authority. | 1 | 9 |
| Strategic contracting: Staff renew existing state-wide contracts, assist with researching new state-wide contracts, and provide support to cooperative members. | 14 | 2 |
| Systems support: Staff support ProcureAZ and operate a help desk. | <u>4</u> | <u>1</u> |
| Total | <u>21</u> | <u>17</u> |

¹ Other sources include appropriated monies that were used to operate the Department's procurement office, such as the State General Fund, or for specific purposes such as paying for a staff position to handle procurements related to a specific fund, such as the Special Employee Health Fund.

Source: Auditor General staff review and compilation of department procurement staffing information as of June 23, 2014.

of its procurement staff positions, or 21 of the 38 positions. Additionally, even though the Department's state-wide contracts and ProcureAZ functions are primarily used by and support state agencies, 86 percent of procurement personnel costs related to these functions were paid using program fee monies.¹ The Department has also used the program fee revenue to pay for procurement training and compliance staff positions that have very limited involvement with the purchasing cooperative program. Although some of the Department's procurement positions support and provide services to the purchasing cooperative program and its members, the Department has not conducted any type of cost analysis to determine how many of its procurement positions should be supported, in full or in part, by program fee revenue.

- **Paying for most of the cost of the state electronic procurement system**—Between fiscal years 2008 and 2014, the Department paid approximately \$8.6 million for the purchase, implementation, management, and maintenance of its electronic procurement system, ProcureAZ. Nearly \$7.4 million of this amount, or 86 percent, came from program fee monies.² Although the Department noted in budget documents

¹ The 86 percent of procurement positions are composed of employees working in the strategic contracting and systems support units.

² Other funding used to pay for ProcureAZ costs included nearly \$1.2 million in State General Fund monies and approximately \$47,000 from the Department's Automation Fund.

submitted to the Governor's Office of Strategic Planning and Budgeting that it intended to use program fee revenue to operate and maintain its electronic procurement system, only a small percentage of the contracts listed on ProcureAZ are state-wide contracts available for use by the purchasing cooperative members. For example, as of July 1, 2014, only 957 of 5,560, or 17 percent, of the active contracts on ProcureAZ were state-wide contracts. Further, department officials reported that program fee monies have been reserved to pay for managing the link between ProcureAZ and the State's accounting system, the Arizona Financial Information System or AFIS, and as a contingency to help pay for linking ProcureAZ to the State's new accounting system, which the Department is developing and expects to implement in calendar year 2015.¹ Because it set aside program fee monies for this interface, the Department reported that it did not request any appropriated monies to cover the cost of linking ProcureAZ with the State's new accounting system.

Additionally, according to a department official, in fiscal year 2013, the Department used \$135,000 in program fee revenue for a one-time tenant improvement project to modify its procurement office facilities and to create a procurement training room. However, similar to procurement staffing and the purchase, implementation, management, and maintenance of ProcureAZ, this tenant improvement project did not solely benefit the purchasing cooperative program.

Although the Department was unable to provide any documented cost analysis supporting how it determined the 1 percent program fee, a 2012 department document indicated that the program fee came about to help ease the budget deficit the State faced in 2009 and to pay for the costs of a new electronic procurement system. The document indicated that the 1 percent program fee not only covered the cost of the new procurement system, ProcureAZ, but was also expected to generate additional revenues for the State over a 5-year period. The Department implemented the 1 percent program fee in July 2009, replacing the \$1,045 annual membership fee that had been previously charged to purchasing cooperative members.

Department should evaluate the purchasing cooperative program's costs and align the program's fee

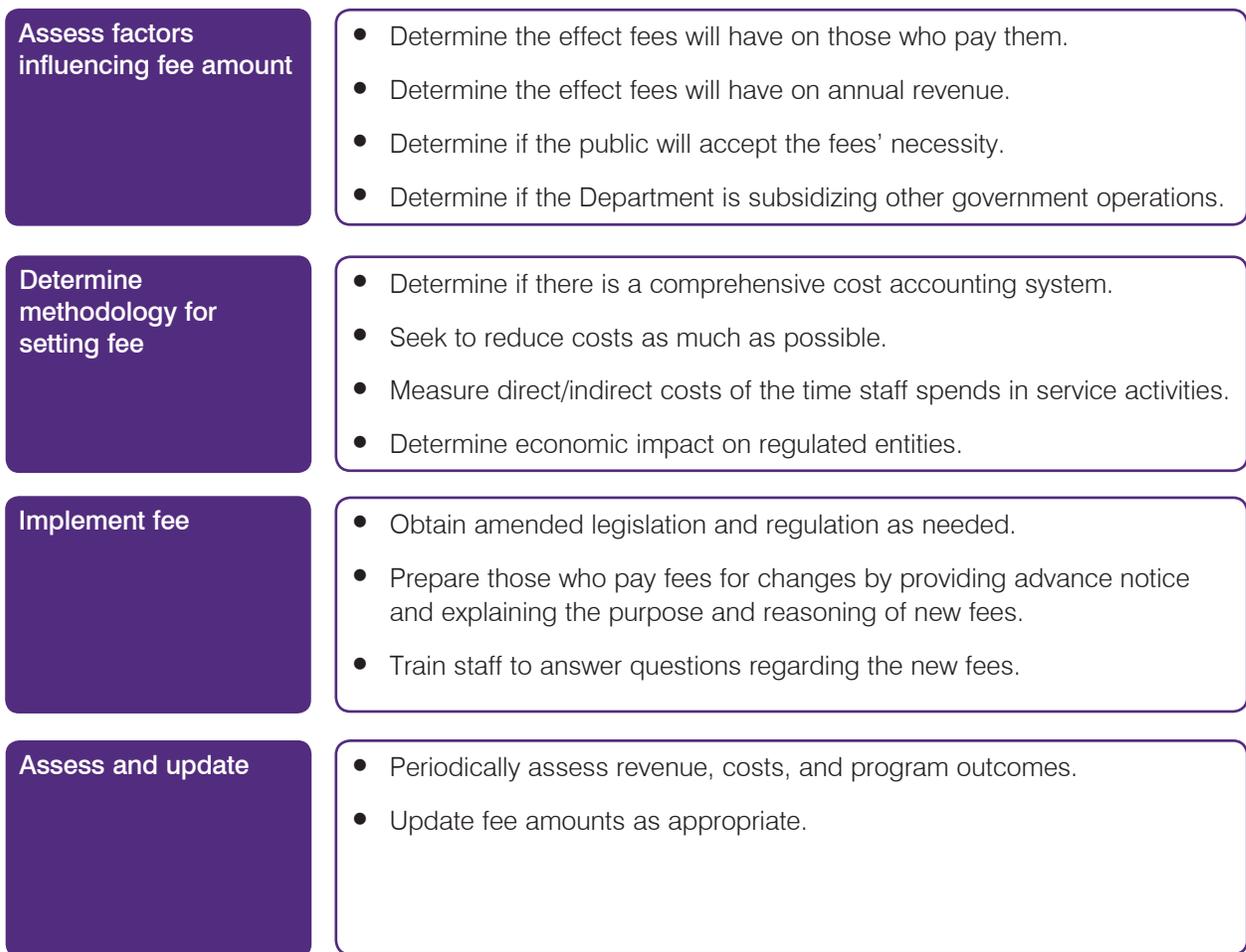
The Department should take steps to evaluate its purchasing cooperative program costs and better align its program fee with these costs. To evaluate its costs and program fee, the Department should implement a structured approach. Mississippi's Joint Legislative Committee on Performance Evaluation Expenditure Review (PEER) developed an approach for evaluating and setting fees that may assist the Department.² PEER's approach consists of a decision model for establishing or increasing government fees, called the Theory of Fee Setting in Government, as well as guidance on implementing new fees. This process aligns with federal fee guidance and a 2008 U.S. Government Accountability Office report on designing federal user fees.³ Figure 1, page 8, summarizes some of the key concepts from PEER's approach.

¹ The Department noted in its fiscal year 2016 budget that it intended to use the program fee revenue fund balance as a contingency for unknown expenses associated with the interface between ProcureAZ and the new state accounting system.

² Joint Legislative Committee on Performance Evaluation Expenditure Review. (2002). *State agency fees: FY 2001 collections and potential new fee revenues*. Jackson, MS: Author.

³ Office of Management and Budget Circular No. A-25; and United States Government Accountability Office. (2008). *Federal user fees: A design guide* (GAO-08-386SP). Washington, DC: Author.

Figure 1: Mississippi PEER structured fee-setting process developed for state government



Source: Auditor General staff summary of fee-setting model included in *State agency fees: FY 2001 collections and potential new fee revenues* report prepared by the Mississippi Joint Legislative Committee on Performance Evaluation Expenditure Review.

The Department's approach should include the following:

- **Assessing the efficiency of operations**—The Department should assess the efficiency of its purchasing cooperative program operations to ensure program costs are as low as possible while considering service quality, and document the results of its assessment. As the Department assesses the efficiency of its operations, it should seek to minimize costs where possible.
- **Developing and implementing a cost accounting method**—The Department should develop and implement a method for determining purchasing cooperative program costs, including both direct and indirect costs, and create policies and procedures for using this method (see textbox, page 9). The Department should also establish a cost allocation methodology for tracking and allocating the direct and indirect costs for operating the purchasing cooperative program.

- **Developing program fee based on actual and appropriate costs**—After the Department has identified the actual and statutorily permissible costs it can use to establish the fee for the purchasing cooperative program, it should use these costs to determine the appropriate program fee to charge and set it accordingly.
- **Creating rate-setting policies and procedures that include periodic reviews of rates**—The Department should develop and implement formal fee-setting policies and procedures that require a periodic review of the purchasing cooperative program's costs and fee. The Department lacks any written documentation on how the current program fee was established.

The Department should also consider the effect that proposed program fee changes may have on purchasing cooperative members and obtain their input when reviewing and revising the program fee.

Recommendations:

- 1.1. To ensure its program fee better aligns with its costs to administer the purchasing cooperative program, the Department should implement a structured approach to evaluate its program fee. Specifically, the Department should do the following:
 - a. Assess the efficiency of its purchasing cooperative program operations to ensure costs are as low as possible while considering service quality, and document the results of its assessment. As the Department assesses the efficiency of its operations, it should seek to minimize costs where possible.
 - b. Develop and implement a method for determining purchasing cooperative program costs, including both direct and indirect costs, and create policies and procedures for using this method.
 - c. Establish a cost allocation methodology for tracking and allocating the direct and indirect costs for operating the purchasing cooperative program.
 - d. After the method is developed and costs are appropriately tracked, the Department should use the costs to analyze its program fee structure, determine the appropriate program fee to charge, and set it accordingly.
 - e. Develop and implement formal fee-setting policies and procedures that require a periodic review of the purchasing cooperative program's costs and fee.
 - f. Consider the effect that proposed program fee changes may have on purchasing cooperative members and obtain their input when reviewing and revising the program fee.

Direct costs—The costs that can be specifically identified with a product or service. Typical examples of direct costs are the salaries and benefits of employees providing the service and the costs of the materials and supplies used in providing the service.

Indirect costs—The costs of resources that are jointly or commonly used to produce two or more types of services or products, but are not specifically identifiable with any of the products or services. Typical examples of indirect costs include security, rent, and utilities.

Source: Federal Accounting Standards Advisory Board's *FASAB Handbook of Federal Accounting Standards and Other Pronouncements as Amended as of June 30, 2013*.

FINDING 2

The Arizona Department of Administration (Department) should take several steps to improve the collection of Arizona State Purchasing Cooperative Program fee (program fee) revenue. The Department has not established adequate policies and practices for collecting program fee revenue, and thus cannot ensure that all state-wide contract vendors appropriately report and remit these monies. As a result, the State may not be receiving all the monies due to it. Therefore, the Department should develop and implement policies and procedures to help ensure program fee revenue is appropriately remitted to it and to address several weaknesses in the Department's collection efforts, such as unverified vendor-reported sales and program fee amounts, and inconsistent monitoring and followup on late or missing vendor reports and payments.

Department needs to improve collection of program fee revenue

Department has not ensured that program fee revenue is properly reported and collected

Auditors' review of department data for the Arizona State Purchasing Cooperative Program noted improperly reported program fee amounts by vendors and inadequate followup by the Department on late and missing program fee revenue that vendors should have remitted to the Department. Specifically:

- **State-wide contract vendors have not reported the sales amounts for all purchasing cooperative members and state agencies**—Although the Department requires state-wide contract vendors to report the dollar value of sales made to purchasing cooperative members and state agencies on a quarterly basis, some vendors have not reported this information. Auditors reviewed information in 20 vendor files for the time period of July 1, 2009 through December 31, 2013, and found that 15 vendors did not submit reports as required. For example, one vendor failed to submit any quarterly reports for this time period. After auditors informed the Department of this deficiency, the Department requested and subsequently received the missing reports in June 2014. The vendor's reports indicated that program fee revenue of \$1,737 was due to the Department, and according to department management, it subsequently collected these monies.
- **Vendor reports are inaccurate**—In addition to not receiving some reports at all, the Department received other reports that were inaccurate. Specifically, auditors conducted further analysis of 5 of the 20 vendor files and identified discrepancies between reported amounts for sales to state agencies and state accounting records.¹ For 3 of the 5 vendors, the discrepancies ranged from an over-reported amount of \$483,000 to an under-reported amount of \$51.8 million.² During the audit, the Department requested that the 3 vendors provide revised and missing reports. The vendor that under-reported \$51.8 million in sales to state agencies subsequently provided the Department with revised reports that showed additional state agency sales totaling \$32.3 million, still leaving a \$19.5

¹ Although most state-wide contracts require the vendor to pay a 1 percent program fee on its sales to purchasing cooperative members, some contracts also require the vendor to remit a program fee on sales to state agencies.

² The other two vendors each had discrepancies that were less than \$50,000, which may have resulted from timing differences between when the vendors reported the state-wide contract purchases and when they were actually paid for the purchases.

million difference. Because this vendor's contract required the program fee to be remitted to the Department based on the dollar value of sales to both purchasing cooperative members and state agencies, not verifying the sales amounts reported by this vendor resulted in uncollected program fee revenue of at least \$323,000 and possibly as much as \$518,000.¹

- **Lack of followup on late and missing program fee revenue**—Auditors found that the Department did not collect all program fee revenue in a timely manner, with some program fee revenue amounts owed to the Department remaining outstanding for 2 or more years. Specifically, auditors' review of the 20 vendor files found that the Department did not follow up on late or missing program fee revenue for 5 vendors. Further, according to the Department's fee tracking database, 3 of the 5 vendors had program fee revenue amounts that remained unpaid for 2 or more years. For example, one vendor had \$109,309 in unpaid program fee monies, including \$21,354 that had been outstanding for nearly 2 years and \$64,074 that had been outstanding for more than a year prior to the vendor remitting payment in April 2014.

Department should address collection deficiencies by developing and implementing various policies and procedures

To address the weaknesses in its collections efforts, the Department should develop and implement policies and procedures to help ensure all required program fee revenue is remitted to it. These policies and procedures should require the following:

- **Accurately documenting and communicating required program fee revenue amounts**—The Department typically requires state-wide contract vendors to remit to it on a quarterly basis a 1 percent program fee based on the dollar value of sales to purchasing cooperative members, but department procurement staff may broaden or narrow the applicability of the program fee on a contract-by-contract basis. For example, a department procurement officer may require a state-wide contract vendor to remit to the Department a 1 percent program fee based on the dollar value of sales to both purchasing cooperative members and state agencies, or even exempt a state-wide contract vendor from remitting any program fee. However, the Department has lacked formal procedures for documenting and communicating contractually established program fee rates to the staff responsible for tracking collections. Although department staff responsible for collections could manually research and record program fee rates in the Department's fee tracking database, this process may not ensure that program fee rates are accurately recorded for collections purposes. For example, auditors' review of information in the Department's fee tracking database for the 20 vendors indicated that the Department inaccurately required 1 vendor to remit a 1 percent program fee to the Department based on the dollar value of sales to both purchasing cooperative members and state agencies. Accordingly, the vendor remitted \$8,529 in program fee revenue to the Department. However, this vendor's contract

¹ A department official stated that the Department will continue to research the remaining difference in reported state agency sales for this vendor and collect any unpaid program fee revenue.

indicated that the program fee was applicable only to sales to purchasing cooperative members. Thus, the vendor should have remitted only \$253 to the Department—the amount related to sales to purchasing cooperative members. To help prevent such inconsistencies, the Department should develop and implement policies and procedures to ensure program fee rates are accurately documented and communicated for collections purposes.

- **Verifying reported sales and program fee revenue amounts**—The Department requires vendors to self-report the dollar value of sales to both purchasing cooperative members and state agencies, and calculate and remit program fee revenue based on these reported amounts. However, department staff did not verify these self-reported amounts. Specifically, the Department could not verify the accuracy of remitted program fee revenue based on the dollar value of sales to purchasing cooperative members because it did not have access to members' actual purchasing data; e.g., purchase orders and invoices. Further, the Department did not have a process for verifying the dollar value of vendor-reported state-agency sales amounts to state accounting records. By not verifying the dollar value of reported sales amounts, the Department was unable to ensure that program fee revenue based on these sales amounts was properly reported and remitted.

During the audit, the Department revised its purchasing cooperative agreement to help address this weakness, but further efforts are needed. Specifically, in May 2014, the Department modified its purchasing cooperative membership agreements to allow the Department to also request from members their purchase data for the purpose of verifying vendor-reported sales amounts. In addition to taking this step, the Department should develop and implement policies and procedures to verify vendor-reported sales and program fee amounts to help ensure these amounts are properly reported and all program fee revenue is remitted to the Department.

- **Following up on deficient or delinquent reports and program fee revenue payments**—Although vendors are required to submit reports and applicable program fee revenue payments on a quarterly basis, the Department did not ensure that vendors were submitting the reports and program fee revenue as required. In addition to those vendors specifically identified in auditors' sample of 20 vendors, auditors' review of the Department's database identified additional vendors who were not submitting the required reports and program fee revenue payments, or were not submitting them in a timely manner. Auditors noted that the Department had periodically sent notices to vendors for delinquent reports and program fee revenue payments, but according to a department official, it did not consistently do so.

The Department has taken some action to address this problem, but more is needed. In July 2014, the Department began sending notices to all state-wide contract vendors reminding them that their quarterly reports and program fee revenue payments were due. According to a department official, these notices will continue to be sent 30 days prior to the end of each quarterly reporting period. However, the Department should formalize this process and develop and implement additional policies and procedures that require department staff to follow up on delinquent and/or deficient reports and program fee revenue payments, including those identified in this audit, and as appropriate, take enforcement action as allowed under the state-wide contract or law. Additional policies and procedures should address the timing, form, and content of department communications with vendors to address deficient and/or delinquent reports and program fee revenue payments.

The policies and procedures established by the Department should also include provisions for supervisory oversight of the Department's collections processes and practices, and once developed and implemented, the Department should ensure that its staff are trained on the collections policies and procedures.

Recommendations:

- 2.1. The Department should pursue collection of any unpaid program fee revenue payments, including those identified in this audit, and resolve any discrepancies between vendor-reported sales amounts and state accounting records.
- 2.2. The Department should develop and implement program fee collections policies and procedures that:
 - a. Ensure program fee rates are accurately documented and communicated between staff establishing the program fee and staff responsible for collecting the program fee revenue;
 - b. Verify vendor-reported sales and program fee revenue amounts to help ensure these amounts are properly reported and all program fee revenue is remitted to the Department;
 - c. Formalize its 30-day notification process and require department staff to follow up on delinquent and/or deficient reports and program fee revenue payments. The policies and procedures should address the timing, form, and content of department communications with vendors to address deficient and/or delinquent reports and program fee revenue payments; and
 - d. Guide staff on specific measures to take when enforcing reporting and program fee requirements on noncompliant vendors using any recourse available under the state-wide contract or law.
- 2.3. As part of its collections policies and procedures, the Department should include provisions requiring supervisory oversight of its collections processes and practices.
- 2.4. The Department should ensure that its staff are trained on the collections policies and procedures.

FINDING 3

The Arizona Department of Administration (Department) should strengthen its internal controls over the processing of Arizona State Purchasing Cooperative Program fee (program fee) revenue to ensure its protection. Auditors found that the Department lacked several cash-handling controls that the *State of Arizona Accounting Manual (SAAM)* requires and that are important for several reasons, including reducing the risk of fraud, theft, and loss.¹ Although no improper transactions were detected in the items auditors reviewed, the lack of controls exposed the Department to an increased risk of fraud, theft, and loss. The Department has begun taking steps to strengthen its controls, including moving all cash-handling responsibilities from the Department's procurement office to its accounting office, but additional steps are needed. These include developing detailed cash-handling policies and procedures that address all cash-handling functions.

Department should continue to improve its controls over program fee collections

Various internal control weaknesses identified

Auditors found that the Department did not follow several internal control policies and procedures required by the SAAM to help ensure program fee revenue payments were properly handled, and therefore reduce the risk of fraud, theft, and loss (see textbox for definition of internal control). Specifically:

- Mailed check payments were not opened in the presence of another employee and were not recorded in a log or pre-numbered receipt book to help ensure all receipts were properly recorded and deposited. The Department receives nearly all program fee revenue payments through the mail.
- Checks were not restrictively endorsed upon receipt to reduce the risk that unauthorized persons could cash the checks. Specifically, while examining fiscal year 2009 and 2010 supporting files, auditors found four checks ranging from \$28 to \$594 that were never restrictively endorsed and deposited by the Department. According to available records, two of the four checks were going to be voided because the vendor had remitted incorrect amounts.
- Checks were not always deposited daily as required by the SAAM. As shown in Figure 2 (see page 16), more than one-third of the program fee revenue checks auditors analyzed were not submitted to the department accounting office for deposit for 3 days or more, with some not submitted for more than a month.

Internal control—an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

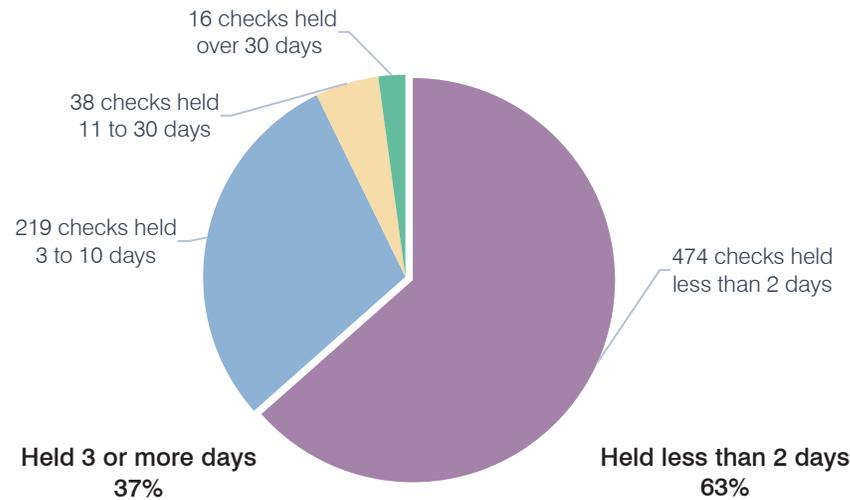
- Effectiveness and efficiency of operations;
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations.

Internal control also serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud.

Source: United States Government Accountability Office. (2014). Standards for internal control in the federal government. (GAO-14-704G). Washington, DC: Author.

¹ The SAAM contains instructional material as well as the State's central accounting policies and procedures. All state agencies are required to comply with the policies and procedures unless otherwise authorized by law or exempted in writing by the department director.

**Figure 2: Number of days program fee payment checks held before being restrictively endorsed and deposited
Fiscal year 2013**



Source: Auditor General staff analysis of department records for program fee payments received in fiscal year 2013.

- Checks were not always properly secured prior to deposit to reduce the risk of theft or loss. Specifically, department staff did not always store checks in secure locations prior to deposit. For example, checks were left in office mailboxes, open baskets, and in files. Further, checks were handled by at least four different staff members and three department divisions/offices prior to being restrictively endorsed and deposited.
- Cash-handling duties were not adequately separated between staff so that no one person had the ability to initiate and complete a transaction without independent review. Specifically, one staff person was responsible for receiving checks and related reports, recording the check amounts and reports in the applicable accounting records, and then forwarding the checks to other department divisions for budget analysis and deposit.
- Fee revenue payments were not properly reconciled to accounting records to help ensure that payment amounts were accurate. Additionally, the Department performed no reconciliation of deposited amounts to recorded program fee revenue payments received and supporting records.

Department has begun taking steps to address internal control weaknesses, but additional action is needed

Although the Department has begun taking action to address weaknesses with its processing of program fee revenue, more needs to be done. Two factors contributed to the weaknesses in its cash-handling processes. First, the Department had not developed any formal, written cash-handling policies and procedures. Second, department staff responsible for processing program

fee revenue payments received only limited on-the-job training. As a result, department staff responsible for receiving and recording program fee revenue payments and vendor reports developed informal procedures based on the limited training they received. Some of the adopted procedures contradicted SAAM requirements, such as holding checks until applicable vendor reports on sales amounts were received and delivering checks to staff who had no cash-handling responsibilities.

The Department has begun to address some of the identified weaknesses. All program fee revenue payment responsibilities have been moved from the Department's procurement office to its accounting office, and all state-wide contract vendors have been notified that program fee revenues are to be remitted to the Department's accounting office beginning July 2014. Further, according to department staff, all checks received are now immediately restrictively endorsed, logged, and deposited. Although the Department's procurement staff will continue to track and record program fee revenues, they will no longer receive actual program fee revenue payments.

In addition to these steps, the Department should develop and implement written policies and procedures that address all accounting and cash-handling functions including segregation of duties, required endorsements, proper use of logs and receipts, and performing reconciliations. All applicable department staff should be provided with and trained on the policies and procedures as appropriate to their assigned duties. Finally, the Department should monitor staff's implementation of the policies and procedures to ensure they are being appropriately followed.

Recommendations:

- 3.1. The Department should continue to implement the changes it has made to help ensure that program fee revenue payments are protected and accurately recorded and deposited, including:
 - a. Transferring all cash-handling responsibilities from the Department's procurement office to its accounting office;
 - b. Ensuring that vendors remit program fee revenue payments to the accounting office; and
 - c. Immediately restrictively endorsing, logging, and depositing all program fee revenue payments.
- 3.2. The Department should develop and implement detailed policies and procedures that address all accounting and cash-handling functions including segregation of duties, required endorsements, logs and receipts, and performing reconciliations.
- 3.3. The Department should distribute the detailed policies and procedures to all applicable staff and provide training on them, as appropriate to staff's assigned duties.
- 3.4. The Department should monitor staff's implementation of the policies and procedures to ensure they are being appropriately followed.

APPENDIX A

Methodology

Auditors conducted this performance audit of the Arizona Department of Administration (Department)—Arizona State Purchasing Cooperative Program (purchasing cooperative program)—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.

The Auditor General and staff express appreciation to the Department's interim director and staff for their cooperation and assistance throughout the audit.

Auditors used various methods to study the issues in this report. These methods included reviewing applicable statutes and rules, and department policies and procedures; interviewing department staff; and reviewing information from the Department's Web site. In addition, auditors used the following specific methods to meet the audit objectives:

- To determine whether the process for establishing the purchasing cooperative program fee (program fee) and using the program fee revenue complied with statutory requirements, auditors reviewed the Department's Arizona State Purchasing Cooperative Agreement provisions and contract terms and conditions applicable to the program fee, department documents to determine how the program fee revenue monies were being used, and fee-setting standards for federal and state governments.¹
- To determine whether the Department appropriately collected program fee revenue, auditors selected a judgmental sample of 20 vendors for July 1, 2009 through December 31, 2013, and examined required quarterly reports, program fee calculations, collections, and supporting documents. In addition, auditors examined processes used to record program fee revenue payments in the Department's fee tracking database and state-wide accounting records maintained in the Arizona Financial Information System (AFIS) and verified that program fee revenue payments recorded as being received in the database were deposited.
- To assess the Department's cash-handling controls, auditors interviewed department procurement and accounting staff on their procedures for processing vendor program fee revenue payments and reviewed available written procedures regarding the process. In addition, auditors observed department staff processing the reports and payments and, where applicable, tested the process against *State of Arizona Accounting Manual* policy. Auditors also analyzed unaudited department data on the number of days it took procurement staff to submit program fee payments to the Department's accounting office for restrictive endorsement and deposit.
- To obtain background information for the report, auditors analyzed unaudited department data on the purchasing cooperative member and state agency sales amounts for fiscal years 2012 through 2014. In addition, auditors compiled and analyzed unaudited information from the

¹ Joint Legislative Committee on Performance Evaluation Expenditure Review. (2002). *State agency fees: FY 2001 collections and potential new fee revenues*. Jackson, MS: Author; Office of Management and Budget Circular No. A-25; and United States Government Accountability Office. (2008). *Federal user fees: A design guide* (GAO-08-386SP). Washington, DC: Author.

AFIS *Accounting Event Transaction File* for fiscal years 2012 through 2014 and the AFIS Management Information System *Status of General Ledger-Trial Balance* screen for fiscal years 2013 and 2014.

- To assess the Department's internal controls over the collection and processing of program fee revenue, auditors examined documentation and observed staff processes for collecting, recording, depositing, and reconciling program fee revenue payments. Auditors' conclusions on the sufficiency of internal controls are reported on pages 11 through 17. In addition, auditors conducted data validation work to determine the reliability of the Department's fee tracking database for reporting program fee revenue payments received. Specifically, auditors selected a judgmental sample of 20 vendors listed on the database and verified that the recorded payments were received and deposited by department accounting staff. Auditors determined that the Department's database was sufficiently reliable for the purpose of reporting vendor program fee revenue payments received. However, because of the Department's poor controls over their purchasing cooperative program records, auditors were unable to determine the completeness of the data in the database.

AGENCY RESPONSE

AGENCY RESPONSE

Janice K. Brewer
Governor



Kathy Peckardt
Interim Director

ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

100 NORTH FIFTEENTH AVENUE • SUITE 401
PHOENIX, ARIZONA 85007
(602) 542-1500

November 6, 2014

Ms. Debbie Davenport
Auditor General
2910 North 44th Street, Suite 410
Phoenix, Arizona 85018

Dear Ms. Davenport:

The Department of Administration has reviewed the preliminary draft of the Arizona State Purchasing Cooperative Program provided by your office. As requested, our written response is detailed below.

1.1.a. The Auditor General finds that the Department should assess the efficiency of its purchasing cooperative program to ensure costs are as low as possible while considering service quality and document the results of its assessment.

The Department is in agreement with the finding and will proceed with implementation of a cooperative purchasing program service efficiency assessment.

1.1.b. The Auditor General finds that the Department should develop and implement a method for determining purchasing cooperative program costs, including both direct and indirect costs, and create policies and procedures for using this method.

The Department is in agreement with the finding and will continue to implement the recommendation to estimate department costs, both direct and indirect. We are preparing a competitive solicitation to obtain expert assistance to analyze and audit the cooperative program. The Division will ensure the final audit/analysis reflects particular emphasis on the best operational and financial practices including cost estimation, resource requirement assessment and policy/procedure development/implementation for a multi-jurisdictional program.

1.1.c. The Auditor General finds that the Department should establish a cost allocation methodology for tracking and allocating the direct and indirect costs for operating the cooperative purchasing program.

The Department is in agreement with the finding and will proceed with implementation. Using information from the effort described in the reply to 1.1.b. above, as well as other information and analysis, we plan to create a cost allocation and tracking methodology to determine the direct and indirect costs for operating the program. The result of the total cost audit will allow the Department to identify the percentage of expenditures necessary to support the program as a whole, including staff, technology, licensing, accessibility, customer service, administrative costs and overhead.

- 1.1.d. The Auditor General finds that the Department should use the costs to analyze its fee structure, determine the appropriate fee to charge, and set it accordingly.

The Department is in agreement with the finding and will proceed with a program cost analysis to determine the appropriate fee structure and execute changes as needed.

- 1.1.e. The Auditor General finds that the Department should develop and implement formal fee-setting policies and procedures that require a periodic review of the cooperative purchasing program costs and fee.

The Department is in agreement with the finding and will proceed with implementation to develop fee-setting policies and procedures.

- 1.1.f. The Auditor General finds that the Department should consider the effect that proposed fee changes may have on the cooperative purchasing program members and obtain their input when reviewing and revising the fee.

The Department is in agreement with the finding and will proceed with implementing an annual cooperative program membership stakeholders meeting. As was done in 2008-2009 when the 1% fee was implemented, the Department will evaluate the potential impact on cooperative purchasing program members. It is important to seek input from our members and other stakeholders on the fee structure and all aspects of the program.

- 2.1. The Auditor General finds that the Department should pursue collection of any unpaid fee review payments, including those identified in this audit, and resolve any discrepancies between vendor-reported sales amounts and state accounting records.

The Department is in agreement with the finding and will proceed with implementing a collection process to collect unpaid fees.

- 2.2.a. Ensure fee rates are accurately documented and communicated between staff establishing the fee and staff responsible for collecting the fee revenue.

The Department is in agreement with the recommendation to establish a cooperative program collection policy and procedure, which shall include a communication plan for ensuring staff are informed of collection policy and procedural changes.

- 2.2.b. Verify vendor-reported sales and fee revenue amounts to help ensure these amounts are properly reported and all revenue is remitted to the Department.

The Department is in agreement with the finding and will proceed with implementation. Vendor-reported sales and the associated fees paid should be verified for accuracy. The best way to accomplish this will be to collect program member's purchasing data and compare it with vendor data. It is important to note, full implementation of this policy and procedure will require participation from program members. Additionally, this implementation will require improved efficiency, such as transforming the current manual, paper-based system into an electronic based system. Investment in technology, staff and data analytics may be necessary to manage the volumes of information collected to ensure accurate fee and collections are obtained. Additional time and dollars may be necessary to fully implement this recommendation. Finally, while there was a discrepancy in revenue collected on some contracts cited in the audit, the Department is limited in its ability to collect the fee on some contracts procured by a national cooperative organization. This contract mechanism is ultimately advantageous to the State so the Department will clarify the collections policy on national cooperative contracts.

- 2.2.c. Formalize its 30-day notification process and require Department staff to follow up on delinquent and/or deficient reports and fee revenue payments. The policies and procedures should address the timing, form, and content of department communications with vendors to address deficient and/or delinquent reports and fee revenue payments.

The Department is in agreement with the finding and will proceed with implementation. As already stated above, the Department has drafted a cooperative program fee collections policy and procedure, which includes formal procedures for notification, communication, and escalation procedures for non-compliant vendors.

- 2.2.d. Guide staff on specific measures to take when enforcing reporting and fee requirements on noncompliant vendors using any recourse available under the statewide contract or law.

The Department is in agreement with the finding and will proceed with implementation. As already stated above, the Department has drafted a cooperative program fee collections policy and procedure, which includes an escalation procedure for Department staff to follow when enforcing the reporting and fee requirements on non-compliant vendors.

- 2.3. The Auditor General finds that the Department should as part of its collection policies and procedures, include provisions requiring supervisory oversight of its collections processes and practices.

The Department is in agreement with the finding and will proceed with implementation. As already stated above, the Department has drafted a cooperative program fee collections policy and procedure, which includes the Department's provisions for supervisory oversight.

- 2.4. The Auditor General finds that the Department should ensure its staff are trained on the collection policies and procedures.

The Department is in agreement with the finding and will proceed with implementation. As already stated above, the Department has drafted a cooperative program fee collections policy and procedure. Immediately following the approval of the program policy and procedure, staff shall have access to the document and receive relevant training.

- 3.1.a. The Auditor General finds that the Department should continue to implement the changes it has made to help ensure that fee revenue payments are protected and accurately recorded and deposited including transferring all cash handling responsibilities from the Department procurement office to the accounting office.

The Department is in agreement with the finding and has already implemented significant changes to cash handling responsibilities and procedures in the months prior to receiving this recommendation. All cash handling responsibilities have been transferred to the Department's Controller. The Controller, as a result of information obtained during the audit process, now reports directly to the Director's Office instead of the General Services Division. Further, we established a Finance Committee within the Department comprised of the Director, Deputy Director, State Comptroller, Deputy State Comptroller and the Department Controller. Among other roles, this Committee will serve as a method of checking on agency financial policies and procedures to ensure those policies are consistently applied; and checking Department practices against developments/findings made by the General Accounting Office or the Auditor General in the conduct of their statewide duties. Finally, the Division has notified vendors about changes in our practices, with instructions to address reports and payments to the Department Controller's office.

In the body of the report, the Auditor General identified internal control weakness as an area of finding. One issue of weak internal controls is the risk of fraud, theft, and loss as highlighted in the report. The Department would like to note that during this audit, the Auditor General did not detect any indication of improper transactions, fraud, theft, or loss of funds.

- 3.1.b. The Auditor General finds that the Department should continue to implement the changes it has made to help ensure that fee revenue payments are protected and accurately recorded and deposited including ensuring that vendors remit fee revenue payments to the accounting office.

The Department is in agreement with the finding and has already implemented this procedural change prior to receiving this recommendation. All cash handling responsibilities are with the Department's accounting office. The Division has notified vendors about changes in our practices with instructions to address reports and payments to the Department Controller's office.

- 3.1.c. The Auditor General finds that the Department should continue to implement the changes it has made to help ensure that fee revenue payments are protected and accurately recorded and deposited including immediately restrictively endorsing, logging, and depositing all fee revenue payments.

The Department is in agreement with the finding and has already implemented this procedural change prior to receiving this recommendation. All cash handling responsibilities are with the Department's accounting office. The Division has notified vendors about changes in our practices with instructions to address reports and payments to the Department Controller's office.

- 3.2. The Auditor General finds that the Department should develop and implement detailed policies and procedures that address all accounting and cash handling functions including segregation of duties, required endorsements, logs and receipts, and performing reconciliations.

The Department is in agreement with the finding and has already implemented this procedural change prior to receiving this recommendation. All cash handling responsibilities are with the Department's accounting office. Notification has been sent to vendors with instructions to address reports and payments to the accounting office. The accounting office shall notify the procurement office when payments are received and processed. Program policies and procedures shall provide steps for logging and reconciling accounting information.

- 3.3. The Auditor General finds that the Department should distribute policies and procedures to all applicable staff and provide training on them, as appropriate to staff's assigned duties.

The Department is in agreement with the finding and will proceed with implementation. As already stated above, the Department has drafted a cooperative program policy and procedure. Immediately following the approval of the program policy and procedure, staff shall have access to the document and receive relevant training.

- 3.4. The Auditor General finds that the Department should monitor staff's implementation of policies and procedures to ensure they are being appropriately followed.

Debbie Davenport, Auditor General

November 6, 2014

Page 6 of 6

The Department is in agreement with the finding and will proceed with implementation. As already stated above, the Department has drafted a cooperative program policy and procedure. The Division will ensure staff have access to and are trained on the new policies and procedures. The Division shall subsequently develop a plan to follow-up on the adherence to the new policies and procedures and any aspects of such that require revisions.

In addition, we also believe there should be additional background/history regarding the program. Please consider the following:

The Cooperative State Purchasing Agreement Fund (CSPAF) was established by the General Accounting Office on June 1, 1990 pursuant to A.R.S. §§ 35-131.H. and 35-142.E. The first CSPAF transactions appearing in AFIS were made in FY 1996. In examining more recent data, CSPAF revenue had a dramatic shift between FY 2009 and FY 2010, due primarily to the imposition of the 1% fee. FY 2010 revenue to the CSPAF hit \$1.85M up from approximately \$286K in FY 2009. CSPAF expenditures also increased significantly during this same timeframe—from \$871K to \$2.38M—primarily associated with ProcureAZ acquisition/development/implementation costs. As the General Fund has become a less reliable source of funding for the Division while the demand for procurement services and oversight has increased, the CSPAF balance and use of it have become more critical for procurement operations.

Among current requirements necessitating a healthy balance and access to the monies, the matter of the ProcureAZ interface with the legislatively approved Enterprise Resource Planning (ERP) Program—the planned replacement to AFIS II—stands out as the most significant. Currently under development and slated for a July 2015 implementation, the ERP, based on decisions made by ADOA in FY 2012, will need to interface with two legacy systems, one of which is ProcureAZ (HRIS is the other). As we have disclosed to your staff, the funding source for ProcureAZ interface costs is the CSPAF. Appropriated funds were not requested by the Department to cover the interface costs, and as previously mentioned the Department determined to not include, as part of the ERP request, funds to purchase new procurement or personnel solutions. Consequently, having sufficient CSPAF monies available for interface requirements is essential for effective ERP implementation.

Regardless of this need and the history of CSPAF practices, the Department has seriously taken note of the issues raised by the Auditor General during multiple meetings held during the audit process.

If you have any questions about this reply, please contact me at 602-542-1500.

Sincerely,

Kathy Peckardt
Interim Director

Performance Audit Division reports issued within the last 24 months

| | |
|-----------------|--|
| 13-01 | Department of Environmental Quality—Compliance Management |
| 13-02 | Arizona Board of Appraisal |
| 13-03 | Arizona State Board of Physical Therapy |
| 13-04 | Registrar of Contractors |
| 13-05 | Arizona Department of Financial Institutions |
| 13-06 | Department of Environmental Quality—Underground Storage Tanks Financial Responsibility |
| 13-07 | Arizona State Board of Pharmacy |
| 13-08 | Water Infrastructure Finance Authority |
| 13-09 | Arizona State Board of Cosmetology |
| 13-10 | Department of Environmental Quality—Sunset Factors |
| 13-11 | Arizona State Board of Funeral Directors and Embalmers |
| 13-12 | Arizona State Board for Charter Schools |
| 13-13 | Arizona Historical Society |
| CPS-1301 | Arizona Department of Economic Security—Children Support Services—Foster Home Recruitment-Related Services Contracts |
| 13-14 | Review of Selected State Practices for Information Technology Procurement |
| 13-15 | Arizona Game and Fish Commission, Department, and Director |
| 14-101 | Arizona Department of Economic Security—Children Support Services—Transportation Services |
| 14-102 | Gila County Transportation Excise Tax |
| 14-103 | Arizona State Board of Dental Examiners |
| 14-104 | Arizona Office of Administrative Hearings |
| 14-105 | Arizona Board of Executive Clemency |
| 14-106 | State of Arizona Naturopathic Physicians Medical Board |
| 14-107 | Arizona Department of Child Safety—Children Support Services—Emergency and Residential Placements |

Future Performance Audit Division reports

Arizona Department of Transportation—Motor Vehicle Division

