



A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Performance Audit

Arizona Department of Administration

Department Should Strengthen Its Management, Support,
and Oversight of the State-wide Procurement System

March • 2015
Report No. 15-102



Debra K. Davenport
Auditor General

The **Auditor General** is appointed by the Joint Legislative Audit Committee, a bipartisan committee composed of five senators and five representatives. Her mission is to provide independent and impartial information and specific recommendations to improve the operations of state and local government entities. To this end, she provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits of school districts, state agencies, and the programs they administer.

The Joint Legislative Audit Committee

Senator **Judy Burges**, Chair

Representative **John Allen**, Vice Chair

Senator **Nancy Barto**

Representative **Gina Cobb**

Senator **Lupe Contreras**

Representative **Debbie McCune Davis**

Senator **David Farnsworth**

Representative **Rebecca Rios**

Senator **Lynne Pancrazi**

Representative **Kelly Townsend**

Senator **Andy Biggs** (*ex officio*)

Representative **David Gowan** (*ex officio*)

Audit Staff

Dale Chapman, Director and Contact Person

Catherine Dahlquist, Team Leader

Rosa Ellis

Chelsea Oertle

Erica Quintana

The Auditor General's reports are available at:

www.azauditor.gov

Printed copies of our reports may be requested by contacting us at:

Office of the Auditor General

2910 N. 44th Street, Suite 410 • Phoenix, AZ 85018 • (602) 553-0333



DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

March 17, 2015

Members of the Arizona Legislature

The Honorable Doug Ducey, Governor

Ms. Kathy 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—State-wide Procurement*. 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 Department agrees with all of the findings and plans to implement or implement in a different manner 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

Department should further align its procurement strategic planning with model planning practices

Our Conclusion

The Arizona Department of Administration (Department) is the State's central procurement authority with responsibility to procure and supervise state purchases of goods and services. Some important elements of a sound state-wide procurement system include a strategic plan, a comprehensive procurement manual, and oversight and management of procurement processes and activities. Although the Department has updated its strategic plan to better focus on improving the state procurement system, it needs to strengthen its procurement strategic planning by conducting an assessment of the state-wide procurement system, developing specific action steps to implement the plan, and developing and monitoring sufficient performance measures. The Department also needs to develop a comprehensive procurement manual to guide the solicitation and administration of state contracts. Finally, the Department should further strengthen its oversight of state agencies' procurements by implementing a risk-based compliance review approach and improving its compliance review checklist and policy.

Procurement strategic planning supports a sound procurement system—The Department is the State's central procurement authority with responsibility to procure and supervise state purchases of goods and services. Literature and best practices indicate that strategic planning is a critical step in managing and improving the performance of a procurement system and creates a more unified approach to procurements. Establishing a cohesive and comprehensive procurement approach is particularly important for Arizona's decentralized procurement system, which includes 95 state agencies with delegated procurement authority that allows these agencies to procure goods and services up to their authorized purchasing amount without the Department's prior approval, more than 5,560 active department and state agency contracts as of July 1, 2014, and approximately \$9.8 billion in expenditures for goods and services in fiscal year 2014.

Department should further improve its procurement strategic plan—Although the Department's fiscal years 2016 through 2020 draft strategic plan includes procurement-related objectives that align with model planning practices, it should further improve its procurement strategic planning by conducting a comprehensive assessment of the state-wide procurement system. According to the Governor's Office of Strategic Planning and Budgeting, the data gathered during this assessment becomes the basis for all other phases of the strategic planning process and will often lead to the identification of strategic issues. The Department should also conduct an overall analysis of state spending on the procurement of goods and services. Literature indicates such an analysis would identify opportunities to leverage buying power, reduce costs, improve operations, and provide better management and oversight of vendors. Finally, the Department should develop and monitor specific action steps and sufficient performance measures to assess the achievement of its procurement-related strategic issues and objectives and report the results to internal and external stakeholders.

Recommendations

The Department should:

- Conduct a comprehensive assessment and spend analysis of the state-wide procurement system; and
- Develop and monitor action steps and performance measures and report the results to internal and external stakeholders.

Department should develop and implement a comprehensive procurement manual

Department lacks a comprehensive procurement manual—Best practices indicate that a comprehensive procurement policy and procedure manual is critical for the operation of an effective procurement system because it helps to ensure the appropriate and consistent application of procurement laws and regulations. Although we previously recommended that the Department develop and implement a compre-



2015

hensive procurement manual, it has yet to do so. Instead, the Department has published some individual procurement policies and procedures, but these have gaps and do not provide staff with detailed, practical instructions on how to conduct key procurement processes appropriately and consistently.

Lack of guidance has contributed to poor contract administration—Effective contract administration is critical, but historically has been a weakness of the State’s procurement system. The Department’s sole policy on contract administration lacks detailed instruction and the Department does not require state agencies to implement contract administration policies and procedures. The lack of procedures had contributed to contract administration problems in some state agencies. For example, the Arizona Department of Economic Security spent nearly \$19 million on performance-based contracts for foster care recruitment-related services in fiscal year 2012, but lacked guidance for effectively monitoring critical elements of these contracts and could not ensure that vendors met all performance expectations.

Recommendation

The Department should develop and implement a comprehensive procurement policy and procedure manual that includes a contract administration section.

Department should further strengthen its oversight of state agency procurements

Department implemented a procurement compliance program in July 2014—Although oversight of state procurement activities is a critical component of an effective procurement system, the Department has historically provided little oversight of state agencies’ procurements. However, in July 2014, it took steps to implement a compliance program to assess and oversee state agencies’ compliance with procurement laws and regulations. Through this program, agencies with unlimited delegated procurement authority will receive an on-site review once every 4 years, and agencies delegated \$100,000 procurement authority will complete a self-assessment once every 4 years. Agencies delegated \$10,000 procurement authority will be reviewed on an as-needed basis. To perform these reviews, the Department developed a review checklist and policy, and instituted mechanisms for corrective action and positive recognition based on compliance review results.

Department should take additional steps to strengthen its procurement compliance program—Some elements of the Department’s compliance program do not align with best practices. These practices indicate that compliance reviews should be conducted frequently enough to ensure compliance and should be based on an assessment of agencies’ risk of noncompliance. Therefore, the Department should implement a risk-based approach for overseeing state agencies’ procurements including developing standard criteria for assessing the risk of noncompliance, conducting regular risk assessments of state agencies, and using the results of these assessments to target oversight efforts. Further, the Department should include additional instructions in its review checklist and policy. Finally, although the Department accepts procurement-related questions and concerns from state employees through an anonymous online system, it lacks formal procedures for investigating and resolving information received through this system. The Department’s compliance officer plans to address received questions and concerns on a case-by-case basis, but this raises issues of timeliness, adequacy, and confidentiality.

Recommendations

The Department should:

- Strengthen its procurement compliance program by implementing a risk-based review approach;
- Revise its compliance review checklist and policy; and
- Develop and implement formal policies and procedures to govern its confidential and anonymous reporting system.

TABLE OF CONTENTS



Introduction	1
Finding 1: Department should further align its procurement strategic planning with model planning practices	9
Procurement strategic planning contributes to a sound procurement system	9
Department revisions to its procurement strategic planning have led to improvement in one area	11
Department should take steps to further improve its procurement strategic plan	12
Strategic planning resources are available to assist the Department	15
Recommendations	15
Finding 2: Department should develop and implement a comprehensive procurement manual	17
Comprehensive procurement manual critical to a sound procurement system	17
Absence of detailed guidance has contributed to contract administration problems	18
Department should use an efficient process that aligns with best practices to develop a comprehensive procurement manual	21
Recommendations	23
Finding 3: Department should further strengthen its oversight of state agency procurements	25
Oversight is an important component of a strong procurement system	25
Department established a compliance program, but some elements do not align with best practices	25
Department should take additional steps to improve oversight	30
Recommendations	32

TABLE OF CONTENTS



Appendix A: Methodology

a-1

Agency Response

Tables

1	Number of Arizona state agencies with a delegated contract procurement limit As of June 2014	2
2	Schedule of revenues, expenditures, and changes in fund balance Fiscal years 2013 through 2015 (In thousands) (Unaudited)	8

INTRODUCTION

Scope and Objectives

The Office of the Auditor General has conducted a performance audit of the Arizona Department of Administration (Department)—State-wide Procurement, pursuant to an October 3, 2013, resolution of the Joint Legislative Audit Committee. This performance audit is the second 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 and focuses on the Department's role in the following elements of a state-wide procurement system:

- Procurement strategic planning,
- Implementing a comprehensive procurement manual, and
- Overseeing and managing procurement.

The first audit focused on the Department's purchasing cooperative program. The final audit(s) will address personnel reform and the statutory sunset factors.

Department responsible for state procurement of goods and services

The Department is the State's central procurement authority and is statutorily responsible for governing, procuring, and supervising state purchases of goods and services (see textbox for definition of procurement). In fiscal year 2014, Arizona state agencies spent an estimated \$9.8 billion in state and federal monies to purchase goods and services.¹

Procurement—The acquisition of materials, services, construction, or construction services. Procurement includes all functions related to obtaining these items, including describing requirements, selecting and soliciting vendors, preparing and awarding contracts, and all contract administration phases.

Source: A.R.S. §41-2503(32).

The state procurement system is partially decentralized. As the central procurement authority, the Department may delegate procurement authority to state agencies. According to department data, as of June 2014, the Department had delegated procurement authority to 95 Arizona state agencies, boards, and commissions. As a result, these state agencies with delegated procurement authority are able to procure goods and services up to their authorized purchasing amount without the Department's prior approval. However, these agencies are still required to use state-wide contracts when buying certain goods and services, such as office supplies and telecommunication services. The agencies are also required to obtain department approval before taking certain purchasing actions, such as procuring goods and services using noncompetitive methods.

The Department's procurement responsibilities include:

- **Procuring goods and services**—The Department reported that it procures goods and services for itself and state agencies when the contract amount exceeds the agency's delegated procurement authority. The Department also establishes state-wide contracts for use by state agencies and members of the Arizona State Purchasing Cooperative (see page 3 for information on the purchasing cooperative program). According to agency records, as of July 1, 2014, the Department had awarded 1,401 contracts, including 911 state-wide contracts.
- **Delegating procurement authority to state agencies**—As previously discussed, the Department had delegated procurement authority to 95 state agencies as of June 2014 (see Table 1, page 2). The amount delegated is based on the expertise, knowledge, and performance of the

¹ The estimated \$9.8 billion was for goods and services purchased by state agencies from third parties that were paid through the Arizona Financial Information System (AFIS). This includes purchases by state agencies exempted from the Arizona procurement code, such as the Arizona Public Safety Personnel Retirement System.

agency's purchasing staff, as well as the impact of the delegation on the agency's purchasing efficiency and effectiveness. For example, as of July 1, 2014, department records showed that the Arizona Department of Transportation (ADOT) had 733 active contracts, with some valued at several million dollars. According to the Department, ADOT was granted unlimited procurement authority because it is more efficient for ADOT's internal procurement unit, with support from relevant ADOT staff, to procure and administer contracts because they can immediately begin the procurement process when a need is identified. In addition, ADOT procurement staff can also better administer the contracts because they have the specialized knowledge to help ensure the procured goods and services adhere to contract specifications.

Table 1: Number of Arizona state agencies with a delegated contract procurement limit As of June 2014

Delegated procurement amount	Number of agencies
\$ 10,000	45
\$100,000	34
Unlimited	<u>16</u>
Total	<u>95</u>

Source: Auditor General staff summary of June 2014 department delegation information.

- Administering and overseeing state agency compliance with purchasing laws and regulations**—The Department administers and oversees state agencies' compliance with the Arizona procurement code, which is a compilation of the laws and regulations governing purchasing in the state procurement system. These responsibilities include establishing state-wide purchasing standards, policies, and procedures, and maintaining a program to ensure state agencies' compliance with the procurement code (see Finding 3, pages 25 through 33, for further discussion of the Department's efforts to assess and ensure state agencies' compliance).

The Arizona procurement code provides several procedures for handling purchases based on the dollar threshold of the procurement. Specifically, for purchases valued at:

- \$10,000 or less**—State agencies must use reasonable judgment in awarding contracts and may, but are not required to, request quotes from potential bidders. Additionally, state agencies may use authorized purchasing cards to pay for purchases, in accordance with policies issued by the State General Accounting Office.
- \$10,001 to \$99,999**—State agencies must request quotes from a minimum of three small businesses.
- \$100,000 or greater**—State agencies must use more formal procedures including inviting bids or requesting proposals from potential bidders.

Absent a specific statutory exemption, the Arizona procurement code applies to any expenditure of public monies by any state agency, board, and commission under any contract for the purchase of materials, services, construction, or construction services.¹ As of July 2014, auditors identified nearly 40 exemptions to the state procurement code,

¹ Arizona Attorney General. (2013). *Arizona agency handbook*. Phoenix, AZ: Author. See Chapter 5 of the handbook for additional clarification regarding A.R.S. §41-2501.

including exemptions for branches of state government, state agencies, and the procurement of specific types of goods and services (see textbox). These exemptions allow state agencies to purchase certain goods and services without adhering to the Arizona procurement code's requirements for competitive bidding.¹ State agencies seek and the Legislature may grant procurement code exemptions for a variety of reasons, which include saving time and administrative costs through expedited contracting processes, and ensuring necessary services are provided to vulnerable populations located outside of metropolitan areas, where only one service provider may be available.

- **Managing and supporting ProcureAZ, the State's electronic procurement system**—The Department provides technical assistance for ProcureAZ users. ProcureAZ allows state agencies to manage solicitations, requisitions, and purchase orders, and also allows vendors to register in the system to receive notifications about bid opportunities or purchase orders that will be issued. The Department's ProcureAZ Help Desk provides technical assistance to state agencies and vendors, including phone and e-mail support; identifies and provides technical training; and monitors support tickets to track the reporting and resolution of system problems.
- **Administering the Arizona State Purchasing Cooperative**—The Department administers a purchasing cooperative program 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 and the federal government. Department records indicate that there were 605 purchasing cooperative program members as of July 1, 2014. For more information on the Department's administration and management of the purchasing cooperative program, see Office of the Auditor General Report No. 14-108, *Arizona Department of Administration—Arizona State Purchasing Cooperative Program*.

Examples of Arizona procurement code exemptions

Entities completely exempt—

Legislative and judicial branches; the Arizona Board of Regents.

Specific services exempt—

Credit reporting services; problem gambling treatment services; contracts for professional witnesses.

Agencies with limited exemptions—

Arizona State Lottery; Arizona Departments of Child Safety, Economic Security, Health Services, and Transportation; Arizona Exposition and State Fair Board.

Source: Auditor General staff summary of A.R.S. §41-2501.

Procurement is an important and vulnerable state function

Effective public procurement is essential for good public services and good government.² Procurement systems support the work of government by facilitating the purchase of needed goods and services, whether these purchases are for routine items such as temporary office staff or furniture, or for more complex areas such as construction or information technology services to support business operations.

¹ For example, the Arizona Exposition and State Fair Board is exempt for contracts for professional entertainment. Additionally, the Arizona Department of Economic Security's contracts for licensed child day care service providers are exempt from the Arizona procurement code.

² Office of Government Commerce. (2008). *An introduction to public procurement*. London, United Kingdom of Great Britain: Author.

Given the large amount of monies involved and the importance of contracting to state agencies to fulfill or support their missions, it is essential that the State apply the highest professional standards when spending money on taxpayers' behalf. As noted earlier, the State spent an estimated \$9.8 billion in state and federal monies on purchased goods and services in fiscal year 2014. According to the Organisation for Economic Co-operation and Development, public procurement is one of the processes most vulnerable to fraud and corruption in government.¹ Similarly, the U.S. General Services Administration has indicated that each year, potentially billions of dollars in federal funds are lost as a result of procurement fraud.² Although auditors noted no specific instances of procurement fraud during this audit, a March 2010 fraud alert that the Office of the Auditor General issued reported that procurement fraud was one of the most common fraud schemes it investigates.³

Because procurement is an important state function that involves large amounts of money and is vulnerable to fraud and corruption, it is essential that state procurement activities are conducted in an efficient, transparent, and accountable manner. If the risks associated with these procurement activities are not effectively managed, the result could be the purchase of unsuitable or unacceptable products or services, increased costs, delays, reduced competition, and unethical conduct.

Recent procurement reform seeks to increase consistency in state procurement practices

During the 2013 and 2014 legislative sessions, the Arizona Legislature made various changes to Arizona's procurement laws to support Governor Janice K. Brewer's objective to reform and modernize state procurement practices. In 2013, Governor Brewer called for reform of the state procurement system to promote greater efficiency and effectiveness and improve consistency in applying and executing procurement laws.⁴ Statutory changes included:

- **New requirements for purchasing employees**—State employees who perform purchasing functions, such as participating in the development of a procurement, soliciting quotes greater than \$10,000, and participating in evaluation committees, are restricted from seeking or accepting employment with companies responding to solicitations for the procurement of goods, services, or construction. This should occur from the time the employee has formally disclosed his/her financial interests and sworn that he/she will not receive any direct benefit from the particular solicitation, and ends at the time the contract is awarded. State employees that perform procurement functions are also restricted from seeking or accepting employment with companies awarded a state contract for 1 year after the purchased goods are delivered or the contracted service or construction begins.

¹ Organisation for Economic Co-operation and Development. (2009). *OECD principles for integrity in public procurement*. Paris, France: Author.

² United States General Services Administration, Office of Inspector General, Office of Audits. (2012). *Procurement fraud handbook*. Washington, DC: Author.

³ Arizona Office of the Auditor General. (2010). *Fraud alert—Procurement fraud (Alert 10-01)*. Phoenix, AZ: Author.

⁴ Brewer, J. K. (2013). *The four cornerstones of reform: Building a framework of effective and responsible governance*. Phoenix, AZ: Author.

Additionally, the Department may transfer the chief procurement officers from agencies with unlimited delegated procurement authority to the Department's staff to strengthen state-wide policy implementation and provide consistent application and management of the procurement process.¹ In fiscal year 2014, the Department entered into interagency service agreements with nine state agencies with unlimited delegated procurement authority, including the Arizona Departments of Transportation and Corrections, to transfer these agencies' chief procurement officers to the Department.

- **New oversight mechanisms**—A.R.S. §41-2511 states the department director shall establish and maintain a procurement compliance program and A.R.S. §41-2612 permits the department director to adopt rules pertaining to vendor performance and evaluation of past performance. The Department's oversight of state agencies' procurements is intended to help ensure that these state agencies properly exercise their delegated procurement authority and adhere to procurement laws and regulations in their contracting for goods and services. Additionally, according to department documents, the information gathered by evaluating vendor performance helps to guide future procurement decisions and protect state and taxpayer interests.

Various factors contribute to a sound procurement system

Various factors contribute to a sound procurement system. Based on a review of public procurement literature and best practices, auditors identified several important elements for a sound state-wide public procurement system, including:

- **Procurement strategic planning**—Effective state-wide procurement strategic planning is important to assess the current performance of a procurement system and to provide a unified direction for the system by establishing goals, objectives, and strategies for implementation. Planning also allows for management of the system through developing and monitoring performance measures to assess and improve the system. See Finding 1, pages 9 through 16, for further discussion of the Department's state-wide procurement strategic planning efforts.
- **Implementing a comprehensive procurement manual**—A comprehensive procurement policy and procedure manual is a critical tool that supports a procurement system's operations by providing purchasing staff with standardized, practical guidance for implementing existing laws and regulations and helping to ensure the consistent and appropriate application of these laws and regulations. See Finding 2, pages 17 through 24, for more information on department efforts to develop a comprehensive procurement policies and procedures manual.
- **Procurement oversight and management**—A strong state-wide compliance program is important to help ensure effective oversight and management of procurement processes and activities; protect against fraud, waste, mismanagement, and abuse of state resources; and enhance integrity, transparency, and public confidence in the procurement system. See Finding 3, pages 25 through 33, for further discussion of the Department's efforts to assess and ensure state agencies' compliance with procurement laws and regulations.

¹ According to A.R.S. §41-2511, the department director shall establish procurement offices as necessary to maintain an effective and efficient program of procurement administration, and shall provide consultation to state agency management in all aspects of procurement to increase efficiency and economy in state agencies by improving the methods of procurement.

Organization and staffing

The state procurement administrator manages the Department's procurement office and its staff.¹ According to the Department, as of January 5, 2015, the procurement office had 39.5 filled full-time equivalent (FTE) positions and 5 vacancies, for a total of 44.5 FTE. The number of full-time equivalent staff positions in the procurement office includes 10 chief procurement officers from state agencies with unlimited delegated procurement authority that the Department transferred to its staff as part of procurement reform legislation, and 1 vacant chief procurement officer position.² According to department staff, the procurement office is organized as follows:

- **Administrative (5.5 filled FTE, 1 vacancy)**—Staff in this unit manage the procurement office's day-to-day operations and support state agencies' procurement activities. In addition, unit staff develop and implement procurement training and compliance programs.
- **Shared services (7 filled FTE, 2 vacancies)**—Staff in this unit provide contracting services to internal department divisions and state agencies with limited delegated procurement authority. These services include soliciting and awarding contracts that exceed an agency's delegated procurement authority, developing contract specifications, facilitating evaluation committees, and providing technical assistance to agencies.
- **Strategic contracting (12 filled FTE, 1 vacancy)**—Staff in this unit provide services associated with state-wide contracts, including facilitating focus groups to discuss contract needs at a state-wide level; soliciting, awarding, and renewing state-wide contracts; evaluating contract bids; and assisting the unit manager to conduct research when there is a need for a new state-wide contract. Additionally, this unit supports the Arizona State Purchasing Cooperative.
- **Systems support (5 filled FTE, 0 vacancies)**—Staff in this unit support and manage ProcureAZ, the State's electronic procurement system, and the Help Desk. ProcureAZ is used to post solicitations, notify registered vendors of available solicitations, and serve as an online, publicly available, official procurement record.

Budget

The Department's procurement office is funded with both appropriated and nonappropriated monies. The majority of its revenues come from a 1 percent program fee remitted to the Department on a quarterly basis by state-wide contract vendors based on the dollar value of sales to purchasing cooperative members.³ As shown in Table 2, page 8, in fiscal years 2013

¹ In accordance with A.R.S. §41-2511, the department director serves as the State's chief procurement officer. However, the director has delegated this procurement authority to the state procurement administrator as allowed by law.

² As of January 5, 2015, the Department had renewed its interagency service agreements with nine state agencies with unlimited delegated procurement authority. According to the Department, there was also an additional agreement pending for a newly hired chief procurement officer.

³ See Arizona Office of the Auditor General Report No. 14-108, *Arizona Department of Administration—Arizona State Purchasing Cooperative Program*, for more information on the purchasing cooperative program fee.

and 2014, the Department received approximately \$4.8 and \$5.6 million in revenues, respectively. In addition to revenues from the 1 percent program fee, the Department received State General Fund monies totaling more than \$1.3 million in fiscal year 2013 and nearly \$1.1 million in fiscal year 2014. The Department estimates it will receive more than \$5.5 million in revenues for its procurement office in fiscal year 2015, including approximately \$955,000 in State General Fund monies.

The Department's procurement office expenditures totaled nearly \$3.7 and \$4.3 million in fiscal years 2013 and 2014, respectively, and are estimated to total more than \$5.5 million in fiscal year 2015. Personal services and related benefits costs accounted for most of these expenditures, representing approximately 57 and 72 percent of expenditures in fiscal years 2013 and 2014, respectively, and an estimated 68 percent of expenditures in fiscal year 2015. In addition, other operating expenditures ranged from approximately \$873,000 to an estimated \$1.1 million for fiscal years 2013 through 2015 and were used primarily for computer and software maintenance and support.

Table 2: Schedule of revenues, expenditures, and changes in fund balance
Fiscal years 2013 through 2015
(In thousands)
(Unaudited)

	2013 (Actual)	2014 (Actual)	2015 (Estimate)
Revenues			
Purchasing cooperative program fee ¹	\$ 3,236.8	\$ 3,767.2	\$ 3,490.7
Intergovernmental revenue ²		593.4	814.0
Appropriations:			
General Fund	1,333.0	1,059.7	954.9
Capital Outlay Stabilization Fund	44.7	21.8	35.2
Special Employee Health Fund	81.8	93.0	94.8
Automation Operations Fund	76.0	82.7	82.4
Corrections Fund	<u>32.4</u>	<u> </u>	<u>35.2</u>
Total revenues	<u>4,804.7</u>	<u>5,617.8</u>	<u>5,507.2</u>
Expenditures and transfers			
Personal services and related benefits ³	2,090.0	3,077.4	3,733.2
Professional and outside services	471.4	230.7	566.2
Travel	2.4	1.8	8.7
Other operating	1,020.0	872.7	1,105.7
Equipment	49.9	58.0	25.8
Indirect costs ⁴	<u>49.0</u>	<u>49.7</u>	<u>67.6</u>
Total expenditures	3,682.7	4,290.3	5,507.2
Transfers ⁵	<u>135.0</u>	<u>19.3</u>	<u> </u>
Total expenditures and transfers	<u>3,817.7</u>	<u>4,309.6</u>	<u>5,507.2</u>
Excess of revenues over expenditures and transfers	987.0	1,308.2	
Fund balance, beginning of year	<u>1,103.7</u>	<u>2,090.7</u>	<u>3,398.9</u>
Fund balance, end of year ⁶	<u>\$ 2,090.7</u>	<u>\$ 3,398.9</u>	<u>\$ 3,398.9</u>

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

² Amount consists of revenues received in accordance with statutes for procurement administration services and facilities the Department provides. Specifically, beginning in fiscal year 2014, statutes required the Department to enter into agreements to provide procurement administration services and facilities to state agencies and the agreements were required to include provisions for reimbursing the Department for the actual costs for the services and facilities provided.

³ According to the Department, amounts increased significantly between fiscal years 2013 and 2015 because the statutorily required procurement reform led to increased staffing and the program fee revenue became more stable and reliable, allowing funding for increased staffing.

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

⁵ According to the Department, the fiscal year 2013 amount consists of transfers to other department funds for services the General Services Division provided for a one-time tenant improvement project to modify the procurement office facilities and to create a training room for procurement training. In addition, 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.

⁶ Amount primarily consists of monies related to the Department's Cooperative Fund. According to the Department, the fund balance for the Cooperative Fund has been strategically reserved to manage the linkage between ProcureAZ and the State's accounting system, the Arizona Financial Information System or AFIS, and as a contingency for the link to the AFIS replacement currently being developed. 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 2013 and 2014; the AFIS Management Information System Status of General Ledger-Trial Balance screen for fiscal years 2013 and 2014; and department-prepared estimates for fiscal year 2015.

FINDING 1

Although the Arizona Department of Administration (Department) updated its fiscal years 2013 through 2017 strategic plan to better focus its efforts on improving the state procurement system, the updated fiscal years 2016 through 2020 draft strategic plan is still deficient in some key areas. To strengthen its procurement strategic planning, the Department should:

- Conduct a comprehensive assessment of the state-wide procurement system to identify the most critical items to include in the plan;
- Develop action steps to implement its strategic plan that are specific, measurable, aggressive/attainable, results-oriented, and time-bound; and
- Develop and monitor performance measures that will assess the achievement of its strategic issues and objectives and report this information to internal and external stakeholders.

Department should further align its procurement strategic planning with model planning practices

Procurement strategic planning contributes to a sound procurement system

Procurement strategic planning, when done effectively, is an important management activity that can help establish a sound procurement system (see textbox for a description of strategic planning). Specifically, procurement strategic planning can facilitate the attainment of a cohesive procurement system.¹ Establishing a cohesive and comprehensive procurement approach is particularly important for Arizona's decentralized procurement system, which includes 95 state agencies with delegated procurement authority, more than 5,560 active department and state agency contracts as of July 1, 2014, and approximately \$9.8 billion in expenditures for goods and services in fiscal year 2014.²

Literature and best practices indicate that strategic planning is a critical step in managing and improving the performance of a procurement system.³ Planning helps to create a common understanding on what is important in procurements and creates a more unified approach to procurements.⁴ According to the Partnership for Public Procurement, by monitoring progress toward procurement goals and identifying areas where performance could improve, or where deviation from established goals can be corrected, an organization can continually improve the effectiveness and

Strategic planning—A

participatory process requiring the full support of the agency director, as well as the involvement of employees at all levels in the agency. A strategic plan guides agencies by asking and answering five basic questions:

- Where are we now?
- Where do we want to be?
- How do we measure our progress?
- How do we get there?
- How do we track our progress?

Source: State of Arizona, Governor's Office of Strategic Planning and Budgeting. (2011). *Managing for results*. Phoenix, AZ: Author.

¹ EU Contact Committee Public Procurement Working Group and EU Contact Committee Public Procurement Updating Group. (2010). In Tribunal de Contas (Ed.) Procurement performance model. In *Public procurement audit* (pp.79-105). Lisbon, Portugal: Author.

² The estimated \$9.8 billion was for goods and services purchased by state agencies from third parties that were paid through the Arizona Financial Information System. This includes purchases by state agencies exempted from the Arizona procurement code.

³ Partnership for Public Procurement. (2012). Public procurement practice: Strategic procurement planning. In *Principles and practices of public procurement*. Stamford, Lincolnshire, NZ: The Chartered Institute of Purchasing & Supply and Herndon, VA: NIGP, The Institute of Public Procurement.

⁴ EU Contact Committee Public Procurement Working Group and EU Contact Committee Public Procurement Updating Group, 2010

efficiency of its procurement operations.¹ Further, engaging in this type of measurement and management of performance can help an organization demonstrate the value of its procurement operations to stakeholders, in terms of verified improvements and accomplishments.

Through strategic planning efforts such as conducting assessments of external environments and developing goals, objectives, and performance measures, other states have been able to improve their procurement practices and plan for the future of their procurement systems. Based on a review of nine other states' Web sites, auditors identified at least seven of these states that had developed strategic plans that included procurement-related goals and/or objectives.² For example:

- The Virginia Department of General Services' (VDGS) 2012-2014 strategic plan included a specific procurement objective to increase the use of the state's electronic procurement system, eVA, by educating both buyers and suppliers. According to VDGS planning documents, this procurement objective supports its overall goals of leading the way in change and innovation in Virginia, improving customers' business processes, and providing cost-effective and efficient services. VDGS reported that using eVA allows the state to leverage its buying power, achieve administrative efficiencies, and provide a central portal to businesses for bid opportunities, thus increasing competition and lowering prices for state agencies, institutes of higher education, and local governments. According to VDGS, although eVA had 53,000 registered vendors and more than 22,600 users as of September 2012, there were additional businesses and local government entities that could join eVA and/or expand their use of the system. In March 2014, VDGS reported that as of June 30, 2013, local government entity and registered vendor participation in the procurement system increased by approximately 12.6 and 7.5 percent, respectively.³
- The California Department of General Services' (CDGS) 2009-2013 strategic plan included a goal to deliver efficient and effective results. To help achieve this goal, CDGS included an objective to ensure that at least 25 percent of all executive agencies' contracting dollars go to certified small businesses and that a minimum of 3 percent goes to disabled veteran business enterprises. According to CDGS, when these firms, which were composed of nearly 99 percent of all California businesses, gain state business, they grow and create jobs. CDGS implemented strategies to help customer agencies attain their objectives, including creating comprehensive outreach programs and policies and regulations that promote the use of small business and disabled veteran business enterprises. CDGS reports on performance measures annually to communicate its progress and achievements. Although not all of the agencies achieved the targets, CDGS reported that as a result of these efforts, during fiscal year 2012, it awarded approximately \$72.1 million, or 38.5 percent, of contracting dollars, associated with CDGS operations, to small businesses, exceeding the state's goal of at least 25 percent small business participation. In addition,

¹ Partnership for Public Procurement. (2012). Public procurement practice: Performance management. In *Principles and practices of public procurement*. Stamford, Lincolnshire, NZ: The Chartered Institute of Purchasing & Supply and Herndon, VA: NIGP, The Institute for Public Procurement.

² Auditors selected seven western states and two additional states recognized by the Pew Center on the States for their innovative procurement practices. The states were California, Colorado, Georgia, Idaho, Oregon, Texas, Utah, Virginia, and Washington.

³ According to VDGS' Web site, as of January 2015, eVA had more than 88,000 registered vendors, but the number of users had decreased to 13,700. A VDGS official indicated that the number of users decreased because the agency eliminated inactive users.

CDGS awarded approximately \$18 million, or 9.6 percent, of its contracting dollars to disabled veteran business enterprises, again exceeding the state's goal of 3 percent.

Department revisions to its procurement strategic planning have led to improvement in one area

Although the Department's fiscal years 2013 through 2017 strategic plan did not adequately address state-wide procurement, updates to the procurement-related elements of this plan better align with model planning practices in one area. As required by Arizona Revised Statutes (A.R.S.) §35-122, the Department developed a 5-year strategic plan for fiscal years 2013 through 2017 that included a procurement-related strategic issue. However, the procurement-related planning reflected in this strategic plan did not align in various ways with model planning practices developed for state agencies by the Arizona Governor's Office of Strategic Planning and Budgeting (OSPB) found in the *Managing for Results* handbook.¹ Specifically, the Department's fiscal years 2013 through 2017 strategic plan included a procurement-related strategic issue, i.e., goal, focused on evaluating key components of the procurement system with the intent to modernize and reform existing practices and expand procurement shared services and transparency. The Department developed objectives, strategies, and performance measures in support of this strategic issue, but these elements did not align with OSPB model planning practices. For example, the objectives were not specific, quantifiable, or time-bound; detailed actions steps were not established to implement all of the strategies in the strategic plan; and the Department did not annually report on its performance measures.

The Department has since revised its strategic plan, including expanding the number of procurement-related strategic issues, objectives, strategies, and performance measures and more closely aligning its procurement-related objectives with OSPB model planning practices. A.R.S. §35-122 requires agencies to annually update their strategic plans, which, according to OSPB model planning practices, allows them to evaluate and report on their progress toward achieving their goals, and to make adjustments to goals, objectives, and strategies to reflect changes in the agencies' internal capacity or the external operating environment. Accordingly, in fall 2014, the Department identified and drafted changes to its strategic plan for fiscal years 2016 through 2020. Specifically:

- **Strategic issues**—The Department has included the following three procurement-related strategic issues in its fiscal years 2016 through 2020 draft strategic plan: (1) improving the delivery of consistent procurement services using standardized formats and procedures; (2) providing, enhancing, and supporting a transparent, effective, electronic procurement system; and (3) developing knowledgeable and skilled public procurement professionals.
- **Objectives**—The Department has included 13 procurement-related objectives in its fiscal years 2016 through 2020 draft strategic plan. These objectives are more closely aligned with OSPB model planning practices, which state that objectives should be specific, quantifiable, and time-bound statements of desired results and represent intermediate achievements that contribute to obtaining the strategic issues. For example, the Department has identified an objective “to develop and publish a state procurement manual by December 2015” to support the strategic issue that focuses on delivering consistent procurement services.

¹ State of Arizona, Governor's Office of Strategic Planning and Budgeting. (2011). *Managing for results*. Phoenix, AZ: Author.

- **Strategies**—The Department has included 11 procurement-related strategies in its fiscal years 2016 through 2020 draft strategic plan. For example, the Department has developed a strategy to “create standardized templates and forms” to achieve the objective that focuses on creating three information technology contract templates for state agencies’ and purchasing cooperative members’ use.
- **Performance measures**—Finally, the Department has included nine procurement-related performance measures in its fiscal years 2016 through 2020 draft strategic plan. For example, the Department has developed an output performance measure to report on the use of standardized policies, procedures, and templates by department staff and state agencies. Output measures are useful for showing the amount of services provided.

Department should take steps to further improve its procurement strategic plan

Although the Department’s fiscal years 2016 through 2020 draft strategic plan includes procurement-related objectives that are specific, quantifiable, and time-bound, the Department should further align its strategic planning efforts with OSPB model planning practices in three areas. First, the Department should ensure its procurement strategic plan is based upon a comprehensive assessment of the state-wide procurement system. Second, it should develop specific action steps to implement the plan’s strategies, align these action steps with SMART—specific, measurable, aggressive/attainable, results-oriented, and time-bound—principles, and assign responsibility for their implementation. Finally, the Department should ensure that it develops sufficient performance measures to gauge success in achieving its procurement strategic issues and objectives, and that it routinely reports this information to internal and external stakeholders.

Conduct comprehensive assessment of procurement system—According to OSPB model planning practices, before an organization begins to chart its future, it must first understand where it stands. This can be done by assessing its internal strengths and weaknesses and external opportunities and threats. As part of this assessment process, organizations should also gather and incorporate customer and stakeholder feedback. According to OSPB, the data gathered during this assessment becomes the basis for all other phases of the strategic planning process and will often lead to the identification of strategic issues. Although the Department previously performed an assessment of its procurement office in 2010, department officials are not aware of any comprehensive assessment performed of the state-wide procurement system.

In lieu of conducting a comprehensive assessment, a department official indicated that the procurement-related strategic issues, objectives, action steps, and performance measures included in its fiscal years 2016 through 2020 draft strategic plan are based on the state procurement administrator’s expanded definition of the strategic issue reflected in the Department’s fiscal years 2013 through 2017 strategic plan. This strategic issue focused on procurement reform, which was intended to promote state-wide procurement efficiency, effectiveness, and consistency (see Introduction, pages 4 through 5, for additional information

on procurement reform). For example, two of the three strategic issues—knowledgeable and skilled procurement professionals and consistent delivery of procurement services—are specific to procurement reform. Although these strategic issues are important and will potentially help the Department focus on implementing procurement reform, because the Department did not conduct a comprehensive assessment of the state-wide procurement system, it potentially has not identified other critical areas for improvement within the state-wide procurement system that should be addressed in its strategic plan.

In addition, the Department has not conducted an overall analysis of state spending on the procurement of goods and services. Spend analysis can be considered a different type of assessment and involves the process of collecting, cleaning, classifying, and analyzing procurement expenditure data. The U.S. Government Accountability Office (US GAO) has stated that a spend analysis is an important driver of procurement strategic planning.¹ Additionally, according to the Partnership for Public Procurement and US GAO, spend analysis allows an organization to identify opportunities to leverage buying power, reduce costs, improve operational performance, and provide better management and oversight of suppliers.^{2,3} Despite the importance of performing a state-wide spend analysis, according to a department official, the spend analysis performed by the Department is limited to procurement officers examining state agency purchasing data to assess contract use and determine whether to extend or re-solicit a contract. Additionally, department staff reported that they do not have specific written guidance in the form of policies and procedures to guide them in conducting spend analysis, nor have they received specific training on conducting spend analysis.

Finally, although the Department has three internal data systems that it can potentially use to provide procurement-related expenditure data, each has limitations for conducting a thorough spend analysis. For example, the data in one system is incomplete, the data in another system is not detailed enough to provide information about the types of goods purchased, and the reliability of the data in the third system is uncertain because it is self-reported by vendors and is not verified by the Department. However, according to the Department, the integration of the state procurement system with the State's new financial system will result in sufficient data to allow the Department to conduct a spend analysis. The Department further explained that the integration is scheduled to be completed in July 2015 and that all agencies except for the Arizona State Retirement System will be using the integrated systems to record procurement-related information, including expenditure information.

Therefore, to help ensure that the Department has identified the most critical state-wide procurement system strategic issues and objectives in its strategic plan, it should conduct a comprehensive assessment of the state-wide procurement system. Further, the assessment should be reviewed and/or updated as part of the Department's annual process for updating and/or revising its strategic plan. Additionally, the Department should conduct a spend analysis. To do so, the Department should evaluate its internal data systems, including its newly integrated procurement and financial systems, once implemented, to determine how best to use this data to

¹ United States Government Accountability Office. (2004). *Best practices: Using spend analysis to help agencies take a more strategic approach to procurement*. [GAO-04-870]. Washington, DC: Author.

² Partnership for Public Procurement. (2012). Public procurement practice: Spend analysis. In *Principles and practices of public procurement*. Stamford, Lincolnshire, NZ: The Chartered Institute of Purchasing & Supply and Herndon, VA: NIGP, The Institute for Public Procurement.

³ United States Government Accountability Office. (2012). *Strategic sourcing: Improved and expanded use could save billions in annual procurement costs*. [GAO-12-919]. Washington, DC: Author.

conduct a spend analysis, develop and implement policies and procedures for conducting a spend analysis, and train staff on these policies and procedures and using its data systems to conduct a spend analysis.

Develop SMART action steps and assign responsibility for their implementation—According to OSPB model planning practices, action steps should be developed to successfully implement the strategies designed to achieve the stated objectives. The action steps should align with SMART principles—specific, measurable, aggressive/attainable, results-oriented, and time-bound—and should also describe who is responsible for performing each step and when it should be completed. Also, because action steps detail how objectives will be implemented, it is important that their execution be monitored. OSPB model planning practices indicate that ideally, monitoring should follow a regular schedule—quarterly or monthly. Further, progress or lack of progress on the action steps should be reported to upper management. However, even though the Department identified 11 procurement-related strategies for the fiscal years 2016 through 2020 draft strategic plan, no action steps and monitoring plan have been developed as of December 2014, according to department officials.

Therefore, the Department should develop and document action steps to guide the implementation of its procurement-related objectives. The Department should ensure that its action steps are SMART, including identifying who is responsible for implementing the steps and when the action steps should be completed. In addition, the Department should regularly monitor the implementation of the action steps to ensure progress is being made.

Develop, monitor and report performance measures to assess achievement of procurement-related strategic issues and objectives—According to OSPB, monitoring performance and reporting results is an important way to measure progress toward achieving strategic issues and objectives. The OSPB model planning practices suggest five types of performance measures—input, output, outcome, efficiency, and quality—that should be used in combination to effectively analyze progress in achieving strategic issues and objectives (see textbox for a description of the different measures). Once performance measures are identified, agencies need to clearly define the performance measures, including what is being measured, and determine the data requirements for each measure, such as identifying the relevant data to collect and ensuring the data are verified and analyzed. Agencies should additionally identify current baselines, i.e., assess current performance, and set realistic performance targets based on external standards, processes, and/or

Types of performance measures

Input—Measures the amount of resources needed to provide particular products or services, and the demand for service.

Output—Measures the amount of products or services provided and focus on the level of activity in a particular program.

Outcome—Measures whether services are meeting proposed targets and reflect the actual results achieved, as well as program impact or benefit.

Efficiency—Measures the productivity and cost-effectiveness of operations.

Quality—Measures effectiveness in meeting the customers' and stakeholders' expectations.

Source: State of Arizona, Governor's Office of Strategic Planning and Budgeting. (2011). *Managing for results*. Phoenix, AZ: Author.

best practices. Finally, agencies should report actual performance against expected results to internal and external stakeholders.

Although the Department's fiscal years 2016 through 2020 draft strategic plan includes nine procurement-related performance measures, these measures may not adequately assess the Department's progress toward achieving its strategic issues and objectives. For example, the Department developed an output, outcome, and quality performance measure related to its strategic issue focused on establishing a professional development program for state procurement staff that promotes staff's understanding of public procurement, ensures their professional competence, and fosters consistent practice. However, these measures are not clearly defined. For instance, the outcome measure that focuses on a percentage of state procurement staff completing training does not clarify what training, i.e., internal baseline training or external supplemental training; nor which staff qualify as state procurement staff. Further, the Department has not established any efficiency or input measures to track the cost to implement the professional development program or the demand for training. Finally, the performance measures do not address one of the intended outcomes of the strategic issue; specifically, consistency in practice. Auditors' review of the performance measures associated with the other procurement-related strategic issues and objectives identified similar gaps.

Therefore, the Department should ensure it has developed sufficient and appropriate performance measures to assess the achievement of its strategic issues and objectives, including ensuring that an appropriate combination of performance measure types are used, that the measures are clearly defined, and that realistic performance targets are identified through comparisons to external standards and/or best practices. Further, the Department should monitor its performance measures and report the results to internal and external stakeholders on an annual basis at a minimum.

Strategic planning resources are available to assist the Department

The level of strategic planning recommended by OSPB, literature, and best practices will require time and staff resources; however, resources are available that may help facilitate the Department's procurement strategic planning. As mentioned previously, OSPB has developed a model planning practices handbook, titled *Managing for Results*, to help state agencies construct successful strategic plans. Additionally, the Department could seek assistance from its assigned OSPB analyst if additional planning expertise is needed.

Recommendations:

- 1.1. The Department should conduct a comprehensive assessment of the state-wide procurement system to help ensure that the Department has identified the most critical state-wide procurement system strategic issues and objectives in its strategic plan. This comprehensive assessment should be reviewed and/or updated as part of the Department's annual process for updating and/or revising its strategic plan.

- 1.2. The Department should conduct a spend analysis as part of the comprehensive assessment. To do so, the Department should:
 - a. Evaluate its internal data systems, including its newly integrated procurement and financial systems, once implemented, to determine how to best use these systems to conduct a spend analysis;
 - b. Develop and implement policies and procedures for conducting a spend analysis; and
 - c. Train staff on these policies and procedures and using the various data systems to conduct a spend analysis.
- 1.3. The Department should develop and document action steps to guide the implementation of its procurement-related objectives. The Department should ensure that its action steps align with SMART principles, include information on who is responsible for implementing them and when they should be completed, and are regularly monitored.
- 1.4. The Department should ensure it has developed sufficient performance measures to assess the achievement of its procurement-related strategic issues and objectives, including ensuring that an appropriate combination of performance measure types are used, that the measures are clearly defined, and that realistic performance targets are identified through comparisons to external standards and/or best practices.
- 1.5. The Department should monitor its performance measures and report the results to internal and external stakeholders on an annual basis at a minimum.

FINDING 2

Despite previous recommendations made by the Office of the Auditor General, the Arizona Department of Administration (Department) has not developed and implemented a comprehensive procurement policy and procedure manual to guide the solicitation and administration of state contracts. A procurement manual is critical to the operations of a procurement system because it helps to ensure the appropriate and consistent application of procurement laws and regulations. The lack of a comprehensive procurement manual and the Department's inadequate existing procurement policies and procedures have contributed to state agencies' poor contract administration. Therefore, the Department should develop and implement a comprehensive procurement manual that includes detailed policies and procedures that address all critical procurement functions and duties.

Department should develop and implement a comprehensive procurement manual

Comprehensive procurement manual critical to a sound procurement system

Literature and best practices state that a comprehensive policy and procedure manual is critical to support the operations of an effective procurement system, and is even more important for partially or fully decentralized procurement systems, like Arizona's. According to the U.S. Government Accountability Office (US GAO), a comprehensive procurement manual is a critical tool that provides purchasing staff with standardized, practical guidance for implementing procurement laws and regulations, and helps to ensure the consistent understanding and application of these laws and regulations.¹ The US GAO also states that policies and procedures are the key mechanisms that help government entities obtain reasonable assurance that there is accountability for government resources. Additionally, literature states that when purchasing responsibilities are shared across many organizations—such as in Arizona's partially decentralized procurement system—the result can be a lack of uniformity in procurement actions and reduction in accountability.² Therefore, a procurement manual becomes more important in a decentralized procurement system because it helps to ensure appropriate and consistent application of procurement laws and regulations.³

Arizona's partially decentralized procurement system includes 95 state agencies with delegated procurement authority and more than 5,560 active department and state agency contracts as of July 1, 2014. In fiscal year 2014, Arizona state agencies spent an estimated \$9.8 billion in state and federal monies for contracted goods and services.⁴

¹ United States Government Accountability Office. (2007). *District of Columbia procurement system needs major reform* [GAO-07-159]. Washington, DC: Author.

² Prier, E., & McCue, C.P. (2009). The implications of a muddled definition of public procurement. *Journal of Public Procurement*, 9(3/4), 326-370.

³ Organisation for Economic Co-operation and Development. (2009). *Methodology for assessing procurement systems* (MAPS). Paris, France: Author.

⁴ The estimated \$9.8 billion was for goods and services purchased by state agencies from third parties that were paid through the Arizona Financial Information System. This includes purchases by state agencies exempted from the Arizona procurement code.

Absence of detailed guidance has contributed to contract administration problems

Despite previous recommendations that it should do so, the Department has not implemented a comprehensive procurement manual to provide procurement staff state-wide with policies and procedures to guide the solicitation and administration of state contracts and help ensure the appropriate and consistent application of procurement laws and regulations. Instead, the Department has published some individual procurement policies and procedures, which lack detailed, practical instructions on important procurement processes. The lack of a comprehensive procurement manual and the Department's inadequate existing policies and procedures have contributed to state agencies' poor contract administration.

Department lacks a comprehensive procurement manual—Although the Office of the Auditor General has previously recommended that the Department develop and implement a comprehensive procurement manual, it has not done so. As the State's central procurement authority, the Department is responsible for administering procurement laws and regulations, and establishing policies and procedures to facilitate compliance with these laws and regulations.¹ Auditors' review of Arizona's procurement laws and regulations found that they align with best practices. However, the Department has not implemented a procurement manual to provide staff with a practical guide for implementing these laws and regulations appropriately and consistently, and to help ensure staff have a clear understanding of legal requirements. The Office of the Auditor General's June 2005 performance audit of the Department (see Report No. 05-02) recommended that it develop and implement a comprehensive procurement manual. The report stated that the Department could improve oversight and foster more consistent procurement practices among state agencies by developing an internal procedure manual for use by procurement staff state-wide. Additionally, the report stated that procurement staff within the Department and at state agencies had expressed the need for such a manual. The Department provided a draft table of contents to the Office of the Auditor General in 2007 to demonstrate it was in the process of implementing the report's recommendation, but it did not finalize or publish this manual.

Existing procurement policies and procedures are inadequate—In lieu of developing a comprehensive procurement manual, the Department has developed some individual procurement policies and procedures. Specifically, the Department has issued some state-wide procurement policies and procedures to supplement existing procurement laws and regulations, provide instructions, and provide information to direct state agencies' procurements. However, auditors identified gaps in the content, completeness, and accessibility of these policies and procedures. Specifically:

- **Policies and procedures lack instructions on key procurement processes**—The Department's individual procurement policies and procedures do not provide state

¹ According to Arizona Revised Statutes §41-2511, the department director is required to procure and supervise the procurement of all materials, services, and construction needed by the State. This statute also requires the department director to ensure compliance with procurement laws and regulations. Additionally, Arizona Administrative Code R2-7-201 specifies that the Department's procurement office establishes procurement policies and procedures and monitors state agencies' compliance with procurement laws. See Finding 3, pages 25 through 33, for information about the Department's oversight of state agency compliance with procurement laws, regulations, policies, and procedures.

agency staff with detailed instructions addressing how to conduct important procurement processes appropriately and consistently. For example, the Department's policy on contract administration provides a high-level discussion of the importance of performing this duty, but lacks detailed instruction on key contract administration functions and procedures such as effectively monitoring contracts to ensure that vendors perform as required, the steps needed to appropriately amend and renew contracts, and proper contract file maintenance. This lack of detailed guidance has contributed to poor contract administration by state agencies (see pages 20 through 21).

- **Ethics policy does not provide practical guidance for addressing conflicts of interest—**The Department's ethics policy is based on a best practice code of ethics, but lacks practical instruction for procurement staff. Specifically, the policy incorporates the code of ethics published by the National Institute of Governmental Purchasing, but lacks practical instruction for procurement staff addressing how to identify and resolve conflicts of interest, and maintain the appearance of propriety in the execution of their procurement duties. Although the policy requires staff to refrain from activity that would create an actual or perceived conflict of interest, it does not include the national organization's instruction on appropriate business meetings and meals or the restriction against staff accepting gifts from vendors. For example, it may be necessary and appropriate for procurement staff to attend professional conferences, business meetings, and meals with vendors, but meeting too frequently with the same vendor or allowing vendors to pay for meals can be perceived as incurring an obligation or an impropriety on the procurement officer's part. The Department's ethics policy does not include this practical guidance. Best practice also indicates that procurement ethical codes of conduct should address actual and perceived conflicts of interest, risks of impropriety, and measures to mitigate such risks, because the appearance of propriety is critical to the success of a public procurement system.¹
- **Referenced materials not available—**The Department's procurement policies and procedures reference materials that are not available to procurement staff throughout the State. For example, some policies and procedures direct state-wide procurement employees to review the *State Procurement Office Glossary* and *Procurement Officer Training Guide* for instruction and information. However, the Department could not provide these resources to auditors.
- **Policies and procedures not easily accessible—**Procurement laws, regulations, and the Department's policies and procedures are posted to different areas of the Department's Web site as individual documents. These documents are not organized by topic and are not linked to facilitate their use to ensure users can efficiently access all applicable requirements and guidance on various procurement topics to assist in their work.

During the audit, the Department established a process to review and update existing policies and procedures on a 3-year cycle. As of September 2014, the Department, in conjunction with the chief procurement officers from state agencies with unlimited delegated procurement authority, had updated some policies and procedures. However, although the Department has generally reviewed and updated one policy or procedure per month, it has not followed its proposed

¹ Interagency Procurement Working Group. (2006). *UN procurement practitioners' handbook*. New York, NY: United Nations Development Programme.

schedule to update two key documents. Specifically, according to department staff, as of December 2014, the procurement office is still in the process of updating its procedure describing contract and procurement file management standards, and has not reviewed and updated the procedure describing contract evaluation and discussion standards and processes.

Lack of guidance has contributed to poor contract administration—Effective contract administration is critical to operating a sound procurement system, but has been identified historically as a weakness of the state procurement system. Contract administration is performed after a contract has been awarded and helps to ensure that the government receives purchased goods and services on time, within budget, and at the specified quality (see textbox).¹ Conversely, poor contract administration can result in poor vendor performance, cost overruns, and delays in receiving goods and services.

Contract administration—Includes many tasks that help to ensure the contract is adhered to and goods or services are delivered as specified, such as:

- Inspecting and accepting delivered goods and performed services;
- Amending and/or modifying existing contracts; and
- Maintaining contract files to retain important documents.

Source: Auditor General staff summary of contract administration responsibilities as defined by the Office of Federal Procurement Policy and the National Association of State Procurement Officials.

Although effective contract administration helps to ensure that organizations, including governments, get what they paid for, the Department's sole policy on contract administration lacks detailed instruction on key contract administration functions and procedures. Further, the Department does not require state agencies to develop and maintain their own contract administration policies and procedures. This lack of guidance has contributed to contract administration problems in state agencies. Specifically, the Office of the Auditor General's June 2005 report (see Report No. 05-02) found that the State's procurement practices lacked proper emphasis on contract administration and reported that procurement staff and officials identified contract administration as a particularly weak area. According to the report, in 2002 and 2003, the Department identified that the State was over-billed by more than \$2 million under its telecommunications contracts. Although the Department reported it recovered these monies, the report cited inadequate contract administration—specifically not reviewing vendor billings against contract terms and pricing—as the cause of this problem. Because neither the laws and regulations included in the Arizona procurement code nor the few policies issued by the Department provided sufficient guidance to state agencies for appropriate administration of their contracts, the report recommended that the Department develop and implement policies, procedures, and/or guidelines for contract administration as part of its effort to develop a comprehensive procurement manual.

Lack of readily accessible procedures for state agencies has contributed to contract administration problems identified in more recent Office of the Auditor General audits of

¹ Office of Federal Procurement Policy. (1994). *A guide to best practices for contract administration*. Washington, DC: Author; and U.S. Merit Systems Protection Board. (2005). *Contracting officer representatives: Managing the government's technical experts to achieve positive contract outcomes*. Washington, DC: Author.

individual state agencies, and also surfaced as a contributing factor to contracting problems identified during this performance audit. Specifically:

- An October 2013 Office of the Auditor General report (see Report No. CPS-1301) found that the Arizona Department of Economic Security (ADES) spent nearly \$19 million in fiscal year 2012 for foster care recruitment-related services using performance-based contracts. However, ADES lacked guidance for effectively monitoring critical elements of these performance-based contracts, such as monitoring performance measures included in the contracts, and did not use performance measurement data to assess contractor performance. Therefore, ADES could not ensure that the vendors were meeting all performance expectations.
- A December 2013 Office of the Auditor General report (see Report No. 13-15) found that the Arizona Game and Fish Commission, Department, and Director did not have policies and procedures to monitor IT service providers, such as requesting and reviewing performance reports, to ensure that the service provider adhered to contract requirements. As a result, the Department could not ensure that key tasks were being performed and that contractual requirements were being met.
- Finally, during this audit, the Arizona Department of Veterans' Services (ADVS) failed to take appropriate action to address a breach of contract involving a contract for physician services. Specifically, in May 2014, the vendor submitted a letter of resignation indicating that the contracted physicians would be leaving their positions at the Arizona State Veteran Home—Phoenix, a skilled nursing care facility for veterans, in 30 days. However, contract provisions required the vendor to provide at least a 60-day notice. Despite this breach of contract, because they lacked knowledge of contracting processes, ADVS staff did not follow proper breach-of-contract protocol.

Department should use an efficient process that aligns with best practices to develop a comprehensive procurement manual

As the State's central procurement authority, the Department should develop and implement a comprehensive procurement policy and procedure manual to help state procurement staff consistently and appropriately follow procurement laws and regulations. Best practice and other states suggest that such a manual is critical to the operation of a sound procurement system. Although the Department has initiated efforts to develop a comprehensive procurement policy and procedure manual, it should ensure that its process for doing so is efficient, and that this manual includes guidance, information, policies, and procedures recommended by best practices.

Best practice and other states suggest the implementation of a comprehensive procurement manual—According to the National Association of State Procurement Officials and the Organisation for Economic Co-operation and Development, a state's central procurement authority is responsible for publishing and maintaining a comprehensive procurement manual to provide practical guidance for procurement employees.¹ Similar to these best practice sugges-

¹ National Association of State Procurement Officials. (2008). *State and local government procurement: A practical guide*. Lexington, KY: Author; and Organisation for Economic Co-operation and Development, 2009.

tions, other states have implemented comprehensive procurement manuals. Specifically, auditors reviewed materials from ten other states' central procurement offices and found that six of these states had developed and implemented comprehensive procurement manuals.¹ These six states reported that their procurement manuals serve as the primary reference for procurement staff in their states and provide detailed guidance and comprehensive information on these states' procurement policies and processes. These states also developed and implemented written policies and procedures addressing contract administration, either within their comprehensive procurement manual or as a separate, detailed guide. For example, Texas and Idaho have developed and implemented separate contract administration guidance that supplements their existing comprehensive procurement policy and procedure manuals. Both states' supplementary contract administration guidance includes information addressing several processes, such as monitoring vendors' performance and remedying nonperformance, correctly changing or amending contracts, maintaining contract records, and contract close-out tasks.

Department has begun taking steps to develop a comprehensive procurement manual, but additional actions needed—The Department has taken some steps to develop and implement a comprehensive procurement policy and procedure manual. According to the Department's procurement office, it has initiated a process for creating a state-wide procurement manual that would provide information and general direction to public procurement employees. According to a department procurement official, the procurement office plans to work with representatives from state agencies with unlimited delegated procurement authority to develop and implement a central procurement manual. As part of this process, the Department distributed background information about Arizona's procurement system and a list of procurement manual topics to these state agencies, with the expectation that the agencies draft individual procurement manuals and then work collaboratively to condense the information into one central procurement manual. The Department also indicated that its comprehensive procurement manual will refer procurement staff to existing procurement statutes, rules, policies, and procedures. The Department estimates the central procurement manual will be published in December 2015.

However, the Department's process for developing a comprehensive procurement policy and procedure manual is inefficient and does not align with best practices. Specifically, requiring individual agencies to expend time and resources drafting individual procurement manuals with different policies and procedures that will then be reviewed and combined into one comprehensive manual for state-wide use does not offer an effective or efficient approach for developing this manual. Further, while including links or references to existing statutes or regulations is important, it is also critical that the Department provide practical, workable guidance for both new and tenured procurement staff to further clarify and explain statutory and regulatory requirements. For example, although the Arizona procurement code states that state agencies shall purchase from state contracts unless the item is significantly different or does not meet the needs of the program, the Department does not provide practical guidance or information to assist procurement staff in determining a "significant" difference. Additionally, as previously discussed, auditors identified gaps in the content, completeness, and accessibility of some of the Department's existing procurement policies and procedures (see pages 18 through 20).

¹ Auditors selected eight western states and two additional states recognized by the Pew Center on the States for their innovative procurement practices. The states were California, Colorado, Georgia, Idaho, Nevada, Oregon, Texas, Utah, Virginia, and Washington.

Therefore, the Department should revise its approach for developing and implementing a comprehensive procurement policy and procedure manual. Specifically, the Department should draft a comprehensive procurement manual, and then ask state agencies to review and provide input on the draft manual. Further, where statutes, rules, and existing policies and procedures related to material in this procurement manual are not sufficiently clear or defined, the Department should supplement reference to these items with additional clarification, explanation, or examples. Finally, consistent with recommendations made by the Partnership for Public Procurement, an international association founded by the Chartered Institute of Purchasing and Supply and the National Institute of Governmental Purchasing's Institute for Public Procurement, the Department's comprehensive procurement manual should, at a minimum, include the following elements:¹

- Clear definitions of procurement terms and processes;
- Instructions for appropriately defining goods or services being procured;
- Instructions and requirements for different contracting methods;
- Instructions for conducting special procurement programs, such as cooperative purchasing;
- Ethical guidelines and a procurement code of conduct;
- Outline of required procurement personnel qualifications, certifications, and training; and
- Guidance on the delegated authorities, roles, and responsibilities of the procurement office and personnel.

Further, the Department's comprehensive procurement manual should include a dedicated contract administration section that includes guidance on performing contract monitoring, amending and renewing contracts, evaluating vendors' performance, addressing poor vendor performance, and maintaining appropriate records. Once the comprehensive procurement manual has been developed and implemented, the Department should train procurement staff throughout the State on the policies, procedures, requirements, and guidance contained in the manual.

Recommendations:

- 2.1. The Department should develop and implement a comprehensive procurement policy and procedure manual to help ensure appropriate and consistent application of procurement laws and regulations throughout the State. As part of this process, the Department should ask state agencies to review and provide input on the draft manual, and should provide additional clarification, explanation, or examples where statutes, rules, and existing policies and

¹ Partnership for Public Procurement. (2012). Public procurement practice: Developing a procurement policy manual. *In Principles and practices of public procurement*. Stamford, Lincolnshire, NZ: The Chartered Institute of Purchasing & Supply and Herndon, VA: NIGP, The Institute for Public Procurement.

procedures are not sufficiently clear or defined. At a minimum, the manual should include the following elements recommended by best practice:

- a. Clear definitions of procurement terms and processes;
 - b. Instructions for appropriately defining goods or services being procured;
 - c. Instructions and requirements for different contracting methods;
 - d. Instructions for conducting special procurement programs, such as cooperative purchasing;
 - e. Ethical guidelines and a procurement code of conduct;
 - f. Outline of required procurement personnel qualifications, certifications, and training; and
 - g. Guidance on the delegated authorities, roles, and responsibilities of the procurement office and personnel.
- 2.2. The Department's comprehensive procurement policy and procedure manual should include a contract administration section that, at a minimum, includes instructions for contract-monitoring activities, correctly amending and renewing contracts, evaluating vendors' performance, addressing poor vendor performance, and maintaining appropriate records.
- 2.3. Once developed and implemented, the Department should train procurement staff throughout the State on the policies, procedures, requirements, and guidance contained in its comprehensive policy and procedure procurement manual.

FINDING 3

Although the Arizona Department of Administration (Department) has taken action to improve its oversight of state agencies' procurements, it should further strengthen these efforts. Oversight is a critical component of an effective procurement system. Historically, the Department has provided limited oversight of state agencies' procurements, although it did conduct some compliance reviews of state agencies' procurements from calendar years 2006 through 2009 and implemented a new oversight program in July 2014 to assess state agencies' compliance with procurement laws and regulations. However, some elements of this new program do not align with best practices. Therefore, the Department should take further action to strengthen its compliance program by implementing a risk-based compliance review approach; improving its compliance review checklist and policy to help ensure reviews are performed consistently and noncompliance is corrected; and developing and implementing policies and procedures governing its confidential and anonymous online reporting system.

Department should further strengthen its oversight of state agency procurements

Oversight is an important component of a strong procurement system

Best practices indicate that essential components of an effective procurement system include mechanisms for monitoring compliance with the procurement system's laws and regulations and for enforcing these laws and rules as necessary. Such oversight helps to ensure existing laws and regulations are applied and enforced in practice; enhances the integrity, transparency, and public confidence in the overall procurement system; and helps to protect state resources against fraud, waste, mismanagement, and abuse.¹⁻⁴

The Department is statutorily required to supervise procurements. Specifically, according to Arizona Revised Statutes (A.R.S.) §41-2511, the department director is required to procure and supervise the procurement of all materials, services, and construction needed by the State. Statutory changes enacted in 2013 also require the department director to establish and maintain programs to ensure state agencies' compliance with procurement laws and regulations. Additionally, Arizona Administrative Code R2-7-201 specifies that the Department's procurement office monitor state agencies' compliance with procurement laws.

Department established a compliance program, but some elements do not align with best practices

Although the Department established a compliance program to improve its management and oversight of the state procurement system in July 2014, some elements of this compliance program do not align with best practices. Historically, the Department has provided little oversight of state agencies' procurements. However, in response to legislation enacted in 2013, the Department established a procurement compliance program designed to

¹ United Nations Commission on International Trade Law. (2012). *Guide to enactment of the UNCITRAL model law on public procurement*. Vienna, Austria: Author.

² Organisation for Economic Co-operation and Development. (2009). *OECD principles for integrity in public procurement*. Paris, France: Author.

³ Personal correspondence from A. Araujo, Director, Procurement Policy and Services Group, Operations Policy and Country Services, The World Bank. Memorandum dated May 23, 2002 RE: Revised Country Procurement Assessment Report Procedures.

⁴ United States Government Accountability Office. (2006). *United Nations procurement internal controls are weak* [GAO-06-577]. Washington, DC: Author.

provide reasonable assurance that state agencies' purchases of goods and services comply with procurement laws and regulations. This new program is generally modeled on best practice, but it does not incorporate some recommended elements of a systematic and effective compliance and oversight program.

Department has historically performed little oversight of state agencies' procurements—Although the Department delegates procurement authority to many state agencies, it has performed little oversight of these agencies' procurements. Specifically, a June 2005 Office of the Auditor General report found that the Department's procurement office had historically performed few oversight functions and that the oversight provided was limited and had significant gaps (see Report No. 05-02). The report identified instances of poorly planned and executed procurements that may have led to significant loss or waste of taxpayer money dating back to 2001. To address this problem, the report recommended that the Department execute its plans to implement a process for conducting procurement compliance reviews of state agencies with delegated procurement authority of \$100,000 or more at least once every 3 years. The report also recommended that in addition to assessing agencies' legal compliance with established laws and regulations, the Department should annually review a random sample of individual procurements to assess procurement value, quality, and state agencies' adherence to best practices.

Consistent with its plans, the Department conducted procurement compliance reviews from calendar years 2006 through 2009 to help ensure that state agencies properly exercised their delegated procurement authority and adhered to procurement laws, regulations, policies, and procedures. According to department records, compliance officers completed 16 procurement compliance reviews during calendar years 2006 through 2009. Auditors reviewed four 2009 compliance review reports and found that these reviews evaluated the training and qualifications of agency purchasing personnel, assessed the comprehensiveness of the agencies' procurement policy and procedure manuals, and included a file review of the agencies' solicitations and contracts to assess compliance with procurement laws and regulations. The reviews varied in scope, depth, and recommendations, but all four reports indicated that the reviewed agencies had generally complied with procurement laws, regulations, policies, and procedures.

However, according to department staff and internal documents, the Department's compliance program was eliminated in calendar year 2009 because of budget limitations. In response, the Department revised its compliance review policy in 2011 to require state agencies with delegated procurement authority of \$100,000 or more to self-audit their procurements at least once every 5 years. According to procurement office management staff, this policy was not formally implemented because the Department did not create an assessment tool, procedures, or a schedule to identify when these audits should be completed. Instead, department staff reported that since calendar year 2009, department review of agencies' procurements has been largely informal, although the Department conducted one formal compliance review, based on a complaint made to the Arizona Office of the Ombudsman–Citizens' Aide in 2013.

Department established compliance program to improve oversight and management over procurement—To improve consistency in the state-wide application and execution of procurement laws, A.R.S. §41-2511 requires that the department director

establish and maintain programs to ensure compliance with applicable procurement laws and rules. In response, as of July 2014, the Department has taken several steps to implement a compliance program, which, according to department staff, is modeled on best practices published by the United States Sentencing Commission.¹ Specifically, the Department has:

- **Revised and distributed a compliance review policy and schedule**—In June 2014, the Department revised its existing procurement compliance review policy, and in July 2014, it published a schedule of agencies it will review during fiscal year 2015 on its Web site.² The policy outlines two types of compliance reviews for state agencies with unlimited and \$100,000 delegated procurement authority (see textbox). According to the Department's policy and department staff, state agencies delegated \$10,000 procurement authority will be reviewed only when it is determined necessary by the state procurement administrator.

- **Created and piloted compliance review process**—The Department has developed a review checklist that its reviewers and state agencies will use to assess agencies' compliance with procurement laws, regulations, policies, and procedures. The Department's compliance officer will use the checklist to conduct his on-site reviews of agencies with unlimited delegated procurement authority, and agencies delegated \$100,000 procurement authority will use the checklist to complete a self-assessment.³ Department and state agency reviewers use the checklist during compliance reviews and self-assessments to evaluate the agency's procurement organization and staffing, purchasing staff's training and qualifications, and the comprehensiveness of the agency's procurement policies and procedures. Additionally, the checklist instructs the reviewers to conduct a file review of the agency's solicitations and contracts. The file review should consist of a representative sample of the state agency's contracting actions, defined as the greater of 10 percent or ten of the prior year's contract files. Contracting actions that should be reviewed include invitations for bid; requests for proposal; and sole source, competition not practical, and emergency procurements.

Types of department procurement compliance reviews

Performance review—The 16 state agencies with unlimited delegated procurement authority will receive an on-site performance review by the Department's procurement compliance unit once every 4 years, based on a schedule the Department sets.

Self-assessments—The 34 state agencies with \$100,000 delegated procurement authority must conduct a self-assessment once every 4 years, based on a schedule the Department sets. The self-assessment consists of agencies completing and submitting a checklist for the Department to review. The instructions also state that based on their self-assessment results, the agencies should identify any areas for corrective action in their responses to the Department.

Source: Auditor General staff summary of department policy and procurement compliance review checklist.

¹ The United States Sentencing Commission is an independent agency in the judicial branch whose purpose is to establish sentencing policies, practices, and detailed guidelines for the federal criminal justice system. The Commission's *Guidelines Manual* provides a framework that establishes the minimum requirements of an effective organizational compliance and ethics program that seeks to help prevent and detect criminal conduct. The components of this compliance and ethics program framework align with other best practices addressing monitoring and oversight programs, including information published by the Organisation for Economic Co-operation and Development and the National State Auditors Association.

² The Department revised the compliance review policy again in August 2014.

³ Through its Web site, the Department has made the self-assessment tool available for all agencies to use as a resource to assist their internal procurement oversight processes. This Web site also notes that state agencies delegated \$10,000 procurement authority are encouraged to regularly conduct sections of the self-assessment voluntarily to assist with their internal procurement oversight.

The compliance officer piloted an on-site compliance review and a self-assessment during the spring of 2014 to evaluate the review process and refine and clarify the questions included in the checklist based on the feedback provided by the reviewed agencies' chief procurement officers. As of December 2014, the compliance officer has conducted three on-site procurement performance reviews using the revised checklist. Additionally, the compliance officer reported that seven agencies submitted their self-assessment results for his review by September 30, 2014, as required.

- **Instituted mechanisms for corrective action and positive recognition**—The Department has instituted mechanisms for corrective action and positive recognition based on compliance review results. Specifically, the self-review checklist for state agencies delegated \$100,000 procurement authority instructs the agencies to identify any areas for corrective action based on the results of their self-assessment, and submit to the Department in writing the proposed corrective action, estimated time frame for completion, and individual responsible for completing the corrective action. Similarly, according to the compliance officer, if during an on-site compliance review he identifies an opportunity for corrective action, he will collaborate with the agency to determine whether corrective action should be taken, what action should be taken, a time frame for completing the corrective action, and the agency staff person responsible for completing the corrective action. The compliance officer is also required to report identified instances of noncompliance to the state procurement administrator, who is authorized to suspend, revoke, or modify the agency's delegated procurement authority, or take other appropriate actions to address noncompliance. Additionally, the Department's procurement office publishes on-site compliance review results in the form of completed checklists and agency responses on its Web site to dually recognize observed compliance excellence and provide state agencies with the opportunity to use these results to identify areas for improvement.

Compliance program does not incorporate some recommended elements of an effective oversight program—Although the Department's new program for overseeing state agencies' compliance with procurement laws, regulations, policies, and procedures incorporates many best practice elements, auditors identified weaknesses in the program. Specifically, the program's compliance review process does not include the following important elements of a systematic and effective oversight process:

- **Compliance review schedule is not based on risk**—The compliance program's 4-year review cycle is inconsistent with best practices. The National State Auditors Association (NSAA) states that compliance reviews should be conducted frequently enough to provide reasonable assurance that entities are in compliance with laws and regulations, should be risk-based, if possible, and that reviewing entities should conduct unscheduled assessments.¹ Additionally, periodic on-site reviews should be conducted to verify any self-reported information and results. Further, the Organisation for Economic Co-operation and Development states that enforcement and followup on findings and recommendations provides an environment that fosters compliance, and recommends that procurement

¹ National State Auditors Association. (2004). *Carrying out a state regulatory program: A National State Auditors Association best practices document*. Lexington, KY: Author.

systems should conduct annual audits and ensure recommendations are responded to within 6 months.¹

However, the Department's review schedule does not require annual audits, is not based on a risk assessment, and does not include unscheduled or random reviews. Instead, the compliance review schedule is based solely on agencies' delegated procurement authority. Specifically, each year, 4 of 16 agencies delegated unlimited procurement authority will have an on-site review and 9 of 34 agencies delegated \$100,000 procurement authority will conduct and submit a self-assessment. The remaining 45 agencies delegated \$10,000 procurement authority will undergo a review when determined necessary. Additionally, the proposed scope of the compliance review includes only solicitations and contracts the agency issued in the preceding 12 months, not from the 4-year time period between reviews. Department staff reported that the 4-year review cycle was determined to be practical based on the Department's limited resources. Specifically, the Department has assigned only one full-time compliance officer to conduct on-site compliance reviews and conduct follow-up work as determined necessary. The Department also hired an intern at the end of August 2014 to assist the compliance officer.

- **Compliance review checklist and policy lack sufficient criteria and guidance**—The Department's procurement compliance review checklist and policy lack sufficient criteria and guidance to help ensure that compliance reviews are performed consistently and adequately, and that noncompliance is corrected. According to the NSAA, standardized review checklists should include appropriate guidance for conducting the review, including how noncompliance will be measured or detected, how reviewers can observe or test noncompliance, and definitions for any terms, classifications, or procedures under review. However, some of the areas identified for review on the Department's checklist lack these criteria and guidance. For example, review areas and questions regarding whether a state-wide contract should have been used, whether an invitation for bid generated a sufficient number of qualified bidders, whether evaluation criteria were fair and appropriate, and whether the procurement officer negotiated a contract that was advantageous to the State lack criteria and guidance to help ensure reviews adequately and consistently assess these areas. Further, even though the Department's compliance policy permits the state procurement administrator to request state agencies take corrective action to remedy noncompliance or resolve procurement review findings, this policy does not indicate that the Department will monitor or follow up on state agencies' implementation of corrective action. As previously stated, best practice indicates that enforcement and followup on findings and recommendations provides an environment that fosters compliance, and recommends that entities with oversight authority follow up on recommendations within 6 months.
- **Department lacks systematic process for investigating and resolving confidential and anonymous reports**—Although the Department has established a reporting mechanism for state employees to submit procurement-related questions and concerns, the Department lacks formal policies and procedures governing how it will investigate and resolve information received through this system. Consistent with the United States Sentencing Commission's recommendation that compliance programs implement systems for employees to report or

¹ Organisation for Economic Co-operation and Development. (2009). *Methodology for assessing procurement systems (MAPS)*. Paris, France: Author.

seek guidance on compliance-related matters, the Department's procurement office Web site includes a confidential reporting mechanism for state employees to submit procurement compliance questions and concerns. However, the Department has not established formal policies and procedures for addressing and resolving these concerns and inquiries. Instead, the Department's compliance officer plans to address complaints and inquiries on a case-by-case basis. This practice could result in untimely and inconsistent resolutions due to the compliance officer's multiple responsibilities and the lack of policies and procedures to help ensure concerns and inquiries are adequately and consistently addressed. Additionally, the Department does not plan to make this reporting mechanism available to vendors participating in the state procurement system or the general public, who may have information pertinent to procurement compliance issues.¹

Department should take additional steps to improve oversight

The Department should take steps to strengthen its management and oversight of the state procurement system to help prevent against fraud, waste, mismanagement, and abuse of state monies. Specifically, the Department should implement a risk-based compliance review approach, which will allow it to focus limited oversight resources where they will have the most impact. Additionally, the Department should address weaknesses in its compliance review checklist and policy. Finally, the Department should develop and implement policies and procedures to govern how it will investigate and resolve information received through its confidential reporting system.

Department should implement a risk-based compliance review schedule—

Best practices recommend that entities with oversight responsibilities implement risk-based approaches to help focus oversight efforts where they are most needed and will have the most impact. Specifically, the U.S. Government Accountability Office (US GAO) recommends that entities establish a comprehensive risk assessment framework for continuously identifying, evaluating, and managing risks in procurement operations.² According to the US GAO, without a comprehensive risk assessment framework, a public procurement entity cannot have reasonable assurance that it focuses proper attention to procurements that could be most prone to fraud, waste, and abuse. Additionally, the US GAO states that effective internal controls are especially important to the oversight of decentralized or geographically dispersed procurement systems, such as Arizona's. To help ensure effective management and oversight of state agencies' procurements while also considering its limited oversight resources, the Department should implement a risk-based approach for overseeing state agencies' procurements by taking the following steps:

- **Department should develop standard criteria for assessing state agencies' noncompliance risk**—To implement a risk-based oversight approach, the Department should first define the criteria it will use to assess the risk of state agencies' noncompliance

¹ In contrast, the United States General Services Administration, which oversees the Federal Acquisition Service that procures goods and services for federal agencies, has an independent Office of Inspector General, which hosts an online reporting tool open to the public to receive reports of fraud, waste, or abuse in federal acquisition programs by employees or vendors.

² United States Government Accountability Office, 2006

with procurement laws, regulations, policies, and procedures. Best practice indicates a standard form of risk measurement is necessary to compare and aggregate risks across an organization.¹ The Department can assess risk using several factors, instead of focusing solely on state agencies' delegated procurement authority. For example, in addition to considering the agency's delegated procurement authority, the Department could also consider the number of procurements the agency conducts annually, the nature of these procurements (i.e., whether they are competitive or noncompetitive), the dollar amount purchased by the agency annually, information received through vendor complaints and protests, prior instances of noncompliance, and, if applicable, the agency's implementation of corrective action.

- **Department should conduct regular risk assessments of state agencies**—Once it has identified risk factors and risk-assessment criteria, the Department should regularly conduct risk assessments of state agencies. Best practice indicates that to identify specific risks to procurement operations and identify areas that require stronger oversight, entities should implement a comprehensive risk assessment framework. Risk assessment is one of five components of internal control, which is a process of identifying, analyzing, and responding to risks facing an entity as it seeks to achieve its objectives (see textbox). As part of its formal risk assessment, the Department could consider requiring all state agencies delegated procurement authority to regularly conduct compliance self-assessments. For example, Georgia's central procurement office requires all state agencies to conduct and submit a procurement compliance self-audit annually.
- **Department should use risk assessment results to target oversight efforts**—Once the Department has completed its risk assessments, it should develop and implement a process to use the results of risk assessments to more strategically focus its oversight efforts. Specifically, the Department should subject high-risk agencies to more frequent compliance reviews, while conducting less frequent reviews of low-risk agencies. Targeting oversight based on risk factors offers state agencies a positive incentive to follow procurement laws and regulations by allowing them to receive fewer on-site compliance reviews if they remain compliant and take other steps to minimize their risks of noncompliance. To complement its risk-based review schedule, the Department should also conduct a small number of unscheduled or random on-site visits as a deterrence mechanism to all state agencies. This practice can help the Department to verify the accuracy and integrity of agencies' self-assessment results and identify areas that may warrant a more detailed review.

Internal control—Is 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 Deloitte & Touche LLP, Curtis, P., & Carey, M. (2012). *Risk assessment in practice*. Durham, NC: The Committee of Sponsoring Organizations of the Treadway Commission.

Department should address weaknesses in its compliance review checklist and policy—The Department should take two additional steps to improve its procurement compliance review checklist and policy. First, the Department should revise its procurement compliance review checklist to provide additional instructions, definitions, assessment criteria, and examples for staff conducting compliance reviews to help ensure that procurement compliance reviews are performed consistently and adequately. Additionally, the Department should strengthen its procurement compliance policy to indicate that the Department will monitor state agencies' implementation of requested corrective action to address noncompliance issues or procurement review findings.

Department should develop and implement policies and procedures governing anonymous reporting system—The Department should also develop and implement formal policies and procedures to govern its confidential and anonymous reporting system. Specifically, these policies and procedures should govern how the Department will investigate and resolve information received through this reporting system and the time frames for investigating and resolving complaints, and stipulate how records will be maintained. Additionally, these policies and procedures should address how the Department will maintain the confidentiality and anonymity of reports and pending investigations. Finally, because complaints can be an important source of information for determining whether entities are in compliance with applicable legal requirements and standards, the Department should define how it plans to incorporate any information received through this system as part of its risk assessment framework.

Recommendations:

- 3.1. To help ensure effective management and oversight of the state procurement system while also considering its limited oversight resources, the Department should strengthen its procurement compliance program by taking the following steps:
 - a. Develop standard criteria for assessing state agencies' risk of noncompliance with procurement laws, regulations, policies, and procedures;
 - b. Regularly conduct risk assessments of state agencies;
 - c. Implement a risk-based state agency review schedule by using the results of its risk assessments to target high-risk state agencies for more frequent reviews, while conducting fewer reviews of low-risk state agencies; and
 - d. Conduct a small number of unscheduled or random compliance reviews annually as a deterrence mechanism to all agencies.
- 3.2. The Department should revise its procurement compliance review checklist to provide additional instructions, definitions, assessment criteria, and examples for staff conducting compliance reviews.

- 3.3. The Department should revise its procurement compliance policy to indicate that the Department will monitor state agencies' implementation of requested corrective action to address noncompliance issues or procurement review findings.
- 3.4. The Department should develop and implement formal policies and procedures to govern its confidential and anonymous reporting system. Specifically, these policies and procedures should:
 - a. Stipulate how the Department will investigate and resolve information received through this reporting system, the time frames for investigating and resolving complaints, and determine how records will be maintained;
 - b. Address how the Department will maintain the confidentiality and anonymity of reports and pending investigations; and
 - c. Define how the Department will incorporate any information received through this system as part of its risk assessment framework.

APPENDIX A

Methodology

This appendix provides information on the methods auditors used to meet the audit objectives.

This performance audit was conducted 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 Arizona Department of Administration's (Department) interim director and staff for their cooperation and assistance throughout the audit.

Auditors used various methods to study the issues addressed in this report. These methods included reviewing applicable statutes and rules, and department policies and procedures; interviewing department staff; observing department monthly meetings with agency chief procurement officers; and reviewing information from the Department's Web site. Auditors also conducted an extensive literature review pertaining to the elements of effective public procurement systems.¹ In addition, auditors used the following specific methods to meet the audit objectives:

- To evaluate the Department's procurement strategic planning, auditors reviewed the Department's fiscal years 2013 through 2017 strategic plan and annual updates, and the Department's draft fiscal years 2016 through 2020 strategic plan. In addition, auditors reviewed and interviewed department procurement staff around procurement strategic planning and their familiarity and use of internal data systems to conduct spend analysis.² Further, auditors reviewed the Arizona Governor's Office of Strategic Planning and Budgeting's 2011 *Managing for Results* handbook and the Partnership for Public Procurement's *Principles and Practices of Public Procurement*, and compared this criteria against the Department's procurement strategic planning practices. Auditors also reviewed planning documents from nine states' Web sites to determine their use of strategic planning for their procurement systems.³
- To assess whether the Department provided sufficient guidance to procurement staff state-wide to perform their procurement job functions appropriately and consistently, auditors examined department procurement policies and procedures available through its Web site, researched procurement industry standards and best practices, and compared the Department's existing procurement policies and standard procedures against this criteria. Auditors also reviewed prior Arizona Office of the Auditor General performance audit reports of state agencies with procurement issues and researched ten other states to determine if they had comprehensive procurement manuals.^{4,5}

¹ Citations for the literature used by auditors are included throughout the report.

² According to the Partnership for Public Procurement, spend analysis is the process of collecting, cleaning, classifying, and analyzing procurement expenditure data.

³ Auditors selected seven western states and two additional states recognized by the Pew Center on the States for their innovative procurement practices. The states were California, Colorado, Georgia, Idaho, Oregon, Texas, Utah, Virginia, and Washington.

⁴ Auditors selected eight western states and two additional states recognized by the Pew Center on the States for their innovative procurement practices. The states were California, Colorado, Georgia, Idaho, Nevada, Oregon, Texas, Utah, Virginia, and Washington.

⁵ Auditors reviewed the following Arizona Office of the Auditor General performance audit reports: Department of Administration—Financial Services Division (Report No. 05-02); Arizona Department of Economic Security—Children Support Services—Foster Home Recruitment-Related Services Contracts (Report No. CPS-1301); and Arizona Game and Fish Commission, Department, and Director (Report No. 13-15).

- To assess the Department's efforts to ensure state agencies' compliance with procurement laws and regulations, auditors reviewed the Department's compliance policies, tools, schedules, and reports; and the compliance regulatory changes initiated by procurement reform enacted in 2013. Further, auditors researched compliance best practices, including those published by the Organisation for Economic Co-operation and Development, the United States Government Accountability Office, and the National State Auditors Association, and compared this criteria against the Department's new compliance tools, schedule, and revised policy documents.¹⁻³ Auditors also interviewed agency staff who participated in the pilot studies of the Department's new compliance review process to obtain their impressions of the review.
- To assess the Department's internal controls related to its procurement strategic planning, written guidance, and oversight, auditors examined relevant documentation and interviewed department procurement staff on how they performed their respective job duties. Auditors assessed this information against best practices. Auditors' conclusions on the sufficiency of internal controls are reported in Findings 1 through 3. In addition, auditors conducted limited validation work to determine the reliability of the contract data in the State's electronic procurement system, ProcureAZ. Auditors determined that the data in ProcureAZ was sufficiently reliable for the purpose of reporting the number of active contracts.
- To obtain background information for the report, auditors compiled and analyzed unaudited information from the Arizona Financial Information System (AFIS) *Accounting Event Transaction File* for fiscal years 2013 and 2014, the AFIS Management Information System *Status of General Ledger-Trial Balance* screen for fiscal years 2013 and 2014, and department-prepared estimates for fiscal year 2015. In addition, auditors reviewed the Department's organizational chart and department information on the procurement authority delegated to state agencies. Further, auditors compiled and analyzed unaudited expenditure data from AFIS to determine the estimated amount of state and federal monies spent by state agencies on goods and services in fiscal year 2014. Finally, auditors analyzed information from ProcureAZ to obtain the number of active contracts as of July 1, 2014.

¹ Organisation for Economic Co-operation and Development. (2009). *Methodology for assessing procurement systems (MAPS)*. Paris, France: Author.

² United States Government Accountability Office. (2014). *Standards for internal control in the federal government*. [GAO-14-704G]. Washington, DC: Author.

³ National State Auditors Association. (2004). *Carrying out a state regulatory program: A National State Auditors Association best practices document*. Lexington, KY: Author.

AGENCY RESPONSE



Douglas A. Ducey
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

March 10, 2015

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-wide Procurement provided by your office. As requested, our written response is detailed below.

1.a. The Auditor General finds that the Department should conduct a comprehensive assessment of the state-wide procurement system to help ensure that the Department has identified the most critical state-wide procurement system strategic issues and objectives in its strategic plan. This comprehensive assessment should be reviewed and/or updated as part of the Department's annual process for updating and/or revising its strategic plan.

The finding of the Auditor General is agreed to and the audit recommendation will be implemented. However, since the state-wide procurement system (ProcureAZ) is currently in process of integrating with the new financial accounting system any current assessment of the system would be invalid. The Department will conduct the review after implementation when the newly integrated systems are determined to be stable and provide a valid baseline.

1.2 The Auditor General finds that the Department should conduct a spend analysis as part of the comprehensive assessment. To do so the Department should:

The finding of the Auditor General is agreed to and the audit recommendation will be conducted as noted in finding 1.a.

1.2.a Evaluative its internal data systems, including its newly integrated procurement and financial systems, once implemented, to determine how best to use this data to conduct a spend analysis.

The finding of the Auditor General is agreed to and the recommendation will be implemented. After July 1, 2015 the newly integrated ProcureAZ and new financial system will have a sufficient data repository to allow for conducting spend analysis.

1.2.b. Develop and implement policies and procedures for conducting a spend analysis; and

The finding of the Auditor General is agreed to and the recommendation will be implemented.

1.2.c. Train staff on these policies and procedures for using the various data systems to conduct a spend analysis.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

1.3. The Auditor General finds that the Department should develop and document action steps to guide the implementation of its procurement related objectives. The Department should ensure that its action steps align with SMART principles, include information on who is responsible for implementing them and when they should be completed, and are regularly monitored.

The finding of the Auditor General is agreed to and the recommendation will be implemented. The Department has developed action plans for the current strategic plan. The plans align with the SMART objectives and include responsible parties and target dates.

1.4. The Department should ensure it has developed sufficient performance measures to assess the achievement of its procurement-related strategic issues and objectives, including ensuring that an appropriate combination of performance measure types are used, that the measures are clearly defined, and that realistic performance targets are identified through comparison to external standards and/or best practices.

The finding of the Auditor General is agreed to and the recommendation will be implemented. The Department has developed performance measures for the current strategic issues and objectives. Those documents were developed using a SMART process.

1.5. The Department should monitor performance measures and report the results to internal and external stakeholders on an annual basis at a minimum.

The finding of the Auditor General is agreed to and the recommendation will be implemented.

2.1. The Auditor General finds that the Department should develop and implement a comprehensive procurement policy and procedure manual to help ensure appropriate and consistent application of procurement laws and regulations throughout the State. As part of this process, the Department should ask state agencies to review and provide input on the draft manual and should provide additional clarification, explanation, or examples where statutes, rules, and existing policies and procedures are not sufficiently clear or defined. At a minimum the manual should include the following elements recommended by best practice:

The finding of the Auditor General is agreed to and will be implemented but state procurement is heavily regulated through statutes and rules. Additionally, the SPA has enacted technical bulletins (policy) and Standard Procedures (procedures) that all delegated procurement staff adhere to as part of their procurement delegation. The uniqueness of each agency's need requires a procurement office to use discretion for determining applicability. The Department agrees that a comprehensive policies and procedures manual would be useful to include additional instructions and best practices for activities that are not explicitly outlined in statute/rule/technical bulletins or standard procedure. The SPO will seek to provide guidance related to procedure and policy, but a one-size fits all state will be challenging.

2.1.a. Clear definitions of procurement terms and processes;

The finding of the Auditor General is agreed to and a different method of dealing with the finding will be implemented. The Arizona State Procurement code contains the definition of procurement terms. The procurement manual will make reference to the appropriate section of the code but will not "re-state" definitions already in place in statute and rule.

2.1.b. Instructions for appropriately defining goods and services being procured;

The finding of the Auditor General is agreed to and the recommendation will be implemented.

2.1.c. Instructions and requirements different contracting methods;

The finding of the Auditor General is agreed to and a different method of dealing with the finding will be implemented. The Arizona State Procurement code contains the definition of procurement terms. The procurement manual will make reference to the appropriate section of the code but will not "re-state" definitions already in place in rule.

2.1.d. Instructions for conducting special procurement programs, such as cooperative purchasing;

The finding of the Auditor General is agreed to and will be implemented. The SPO will issue instructions as part of its series of standard procedures and incorporate appropriate information as part of the procurement manual.

2.1.e. Ethical guidelines and a procurement code of conduct;

The finding of the Auditor General is agreed to and will be implemented.

2.1.f. Outline of required procurement personnel qualifications, certifications, and training; and

The finding of the Auditor General is agreed to and a different method of dealing with the finding will be implemented. The Arizona State Procurement Office has already provided this information in a technical bulletin. The procurement manual will reference the appropriate technical bulletin but it will not "re-state" the requirements.

2.1.g. Guidance on the delegated authorities, roles and responsibilities of the procurement office and personnel.

The finding of the Auditor General is agreed to and a different method of dealing with the finding will be implemented. The Arizona State Procurement Office has already provided this information in a technical bulletin. Specific authority for a procurement office and individual personnel is also managed through a delegation or sub-delegation agreement. The procurement manual will reference the appropriate technical bulletin but it will not "re- state" the requirements.

2.2. The Auditor General finds that the Department's comprehensive procurement policy and procedure manual should include a contract administration section that, at a minimum, includes instructions for contract monitoring activities, correctly amending and renewing contracts, evaluating vendors performance, addressing poor vendor performance, and maintaining appropriate records.

The finding of the Auditor General is agreed to and will be implemented. The procurement manual under development will include a section on contract administration.

2.3. The Auditor General finds that once developed and implemented, the Department should train procurement staff throughout the State on policies, procedures, requirements, and guidance contained in its comprehensive policy and procedure procurement manual.

The finding of the Auditor General is agreed to and will be implemented. As part of the changes to the procurement statute during procurement reform, the Department hired a training officer to begin a comprehensive training and compliance program for all State employees in the procurement series.

3.1. To help ensure effective management and oversight of the state procurement system while also considering its limited oversight resources, the Department should strengthen its procurement compliance program by taking the following steps:

3.1.a. Develop standard criteria for assessing state agencies' risk of non-compliance with procurement laws, regulations, policies, and procedures;

The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The SPO Compliance Unit will establish standard criteria for assessing state agencies' risk of noncompliance with procurement laws, regulations, policies, and procedures. Collected data will be maintained on the SPO Compliance Unit's "Compliance Dashboard" to establish state procurement areas of high risk.

3.1.b. Regularly conduct risk assessments of state agencies;

The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The SPO Compliance Unit will conduct an annual risk assessment at the end of

every fiscal year based on an assessment tool using data collected from the Chief Procurement Officers and information compiled from the compliance reviews completed that year. This process will assist SPO in identifying areas of high risks and opportunities for improvement to state procurement.

3.1.c. Implement a risk-based state agency review schedule by using the results of its risk assessments to target high-risk state agencies for more frequent reviews, while conducting fewer reviews of low-risk state agencies; and

The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The SPO Compliance Unit will coordinate with the State Procurement Administrator each fiscal year to establish the following year's agency compliance review schedule based on the current fiscal year's risk assessment.

3.1.d. Conduct a small number of unscheduled or random compliance reviews annually as a deterrence mechanism to all state agencies.

The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The SPO Compliance Unit will implement quarterly random sampling reviews of contracts for agencies not scheduled for either onsite procurement review or self-assessment. This review will be conducted on the State's eProcurement system, ProcureAZ. The results of this review will be transmitted to the State Procurement Administrator and the respective agency Chief Procurement Officer. The focus of the random sampling review will be on the areas of high risks identified in the aforementioned annual risk assessment. The quarterly sampling will begin in Q1 FY16.

3.2. The Auditor General finds that the Department should revise its procurement compliance review checklist to provide additional instructions, definitions, assessment criteria, and examples for staff conducting compliance reviews.

The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The SPO compliance checklists will be updated to provide additional instructions, definitions, assessment criteria, and examples for staff conducting reviews. Revised checklists will be made available to state agencies.

3.3. The Auditor General finds that the Department should revise its procurement compliance policy to indicate that the Department will monitor state agencies' implementation of requested corrective action to address noncompliance issues or procurement review findings.

The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The compliance program will request the development of a corrective action plan as part of the compliance review process. The SPO will initiate a follow up review process to monitor progress of the corrective action plans. However, the Department will continue to utilize currently

Debbie Davenport, Auditor General
March 10, 2015
Page 6 of 6

available processes, such as those defined in A.R.S. § 41-2511, in conjunction with the review process if the issues discovered during a compliance review warrant intervention. A.R.S. § 41-2511 provides the State Procurement Administrator the authority to reduce, modify, or suspend an agency's delegated procurement authority due to noncompliance, as well as to select agencies for unscheduled compliance review. Agencies non-compliant to procurement laws, regulations, policies, and procedures are subject to these provisions.

3.4. The Auditor General finds that the Department should develop and implement formal policies and procedures to govern its confidential and anonymous reporting system. Specifically, these policies and procedures should:

3.4.a. Stipulate how the Department will investigate and resolve information received through this reporting system, the time frames for investigating and resolving complaints, and determine how records will be maintained;

The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The SPO Compliance Unit will develop a comprehensive procedure for investigating and resolving complaints. The SPO Compliance Unit will identify, within the written procedure, record retention policies consistent with Arizona Records Management Division policy. The procedure for investigating and resolving complaints will be maintained in the SPO Policy and Procedure Manual.

3.4.b. Address how the Department will maintain the confidentiality and anonymity of reports and pending investigations; and

The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The SPO Compliance Unit shall address, within the aforementioned procedure, how the Department will maintain the confidentiality and anonymity of reports and pending investigations.

3.4.c. Define how the Department will incorporate any information received through this system as part of its risk assessment framework.

The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The SPO Compliance Unit will define, within the aforementioned procedure, how the Department will incorporate any information received through the E-Comply system as part of the SPO Compliance Unit's risk assessment framework.

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
14-108	Arizona Department of Administration—Arizona State Purchasing Cooperative Program
15-101	Arizona Department of Child Safety—Child Abuse or Neglect Reports, Substantiation Rate, and Office of Child Welfare Investigations

Future Performance Audit Division reports

Arizona Department of Transportation—Motor Vehicle Division
Arizona Medical Board—Licensing and Registration Processes