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ARIZONA DEPARTMENT OF ADMINISTRATION

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November 6, 2014

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

Dear Ms. Davenport:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Sincerely,

Kathy Peckardt
Interim Director