



A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Sunset Review

Arizona Department of Administration—Sunset Factors

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Report No. 15-109



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Auditor General

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September 3, 2015

Members of the Arizona Legislature

The Honorable Doug Ducey, Governor

Mr. Kevin Donnellan, Acting Director
Arizona Department of Administration

Transmitted herewith is a report of the Auditor General, *A Sunset Review of the Arizona Department of Administration*. This report is in response to an October 3, 2013, resolution of the Joint Legislative Audit Committee and was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq.

As outlined in its response, the Arizona Department of Administration plans to implement all of the recommendations.

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

Sincerely,

Debbie Davenport
Auditor General

Attachment

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INTRODUCTION

Scope and Objectives

The Office of the Auditor General has conducted a sunset review of the Arizona Department of Administration using the criteria in Arizona's sunset law. The review was conducted pursuant to an October 3, 2013, resolution of the Joint Legislative Audit Committee and prepared as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq.

This report includes responses to the statutory sunset factors specified in A.R.S. §41-2954 and is the final in a series of four reports on the Department. The first report focused on the Department's administration of the Arizona State Purchasing Cooperative Program (see Report No. 14-108). The second report evaluated the Department's management, support, and oversight of the state-wide procurement system (see Report No. 15-102). The third report assessed the Department's implementation of personnel reform, which was enacted in 2012 (see Report No. 15-108).

Department supports Arizona's state government operations

The Arizona Department of Administration (Department) was established by the State Legislature in 1972 to provide centralized support services for the operation of state government. Consistent with its mission, the Department has various responsibilities and provides several critical support services to Arizona state agencies and state employees (see textbox).

Department's mission

To serve state government by delivering the highest-quality services to our partners in support of all Arizonans.

Source: Department's *Five-Year Strategic Plan, FY2016 - FY2020*.

Organization and staffing

The Department's duties and responsibilities are performed by seven offices and divisions. The Department reported that as of June 30, 2015, it had 548 filled full-time equivalent (FTE) positions and 118 vacancies, for a total of 666 FTE positions. The staffing and responsibilities of the Department's offices and divisions are as follows:

- **Office of the Director (56 filled FTE positions, 18 vacancies)**—The Director's Office provides strategic planning and operational guidance to the Department and includes the Office of the Controller, which is the Department's internal accounting function, and the Office of Employment and Population Statistics, which collects, analyzes, and disseminates population and labor market statistics. Additionally, this office supports the Governor's Regulatory Review Council (GRRC), and two offices established via Executive Order by former Governor Janice K. Brewer: the Government Transformation Office and the Office of Grants and Federal Resources (see textbox on page 3 for a description of GRRC and the Government Transformation Office).^{1,2}
- **Arizona Strategic Enterprise Technology Office (135 filled FTE positions, 44 vacancies)**—The Arizona Strategic Enterprise Technology Office is responsible for overseeing and providing information technology (IT) services to state agencies, setting state-wide IT policies and procedures, and defining and executing the state-wide IT strategic plan.

¹ Former Governor Fife Symington transferred GRRC to the Department in 1993 by Executive Order to improve the efficiency of state government operations.

² The Office of Grants and Federal Resources was established in 2013. Its mission is to maximize the benefits of federal funding received and increase the grants management capacity of the State of Arizona. Specifically, this office assists state agencies in identifying and applying for grants, and monitors active grants to understand the total amount of grant activity in the State at any point in time.

This office also oversees the state-wide telecommunications network, maintains the State Data Center, and is responsible for monitoring and overseeing high-risk technology projects across all state agencies.

- **General Accounting Office (58 filled FTE positions, 12 vacancies)**—The General Accounting Office is the State’s principal accounting office. This office operates the state-wide accounting system and processes the state-wide payroll, which is calculated by the Human Resources Information Solution (HRIS) system. This office also coordinates and prepares state-wide financial reports; establishes state-wide accounting policies and procedures; performs internal audits; and provides technical assistance and other management advisory services to state agencies.
- **General Services Division (93 filled FTE positions, 21 vacancies)**—The General Services Division is responsible for the Department’s building system, which includes over 4,000 structures, and provides other support services to state agencies. Specifically, this division provides property management, general operations, and maintenance services for state office buildings and structures. This division also administers the acquisition, leasing, planning, inspection, and construction of state facilities. Additionally, this division distributes interagency mail, maintains a state-wide vehicle fleet and an alternative fuel depot, and redistributes surplus state property.
- **Human Resources Division (111 filled FTE positions, 9 vacancies)**—The Human Resources Division has three primary personnel administration responsibilities. First, this division administers the State Personnel System, and supports state agencies in the areas of staffing, compensation, and performance management.¹ As part of these duties, the division sets state-wide personnel policies and procedures. This division also manages and administers state employees’ health benefits (see Sunset Factor 2, pages 7 through 10). Finally, this division supports state-wide human resources IT systems, including the personnel and benefits functions of the HRIS system; the automated recruiting and hiring application, Talent Acquisition; and the automated performance management system, Managing Accountability and Performance.
- **Risk Management Division (59 filled FTE positions, 11 vacancies)**—The Risk Management Division provides state-wide insurance administration and risk management services. Specifically, this division provides insurance coverage to state agencies and employees for property, liability, and workers’ compensation losses through self-insurance and purchased insurance policies. This division also investigates and settles all insurance claims related to state property and liability issues and oversees the state workers’ compensation program.
- **State Procurement Office (36 filled FTE positions, 3 vacancies)**—The State Procurement Office serves as the State’s central procurement authority, and purchases goods and services for the Department and state agencies. This office is also responsible for

¹ For more information about the Department’s responsibilities in managing the State Personnel System, see Report No. 15-108, *Arizona Department of Administration—Personnel Reform Implementation*.

establishing state-wide purchasing policies and procedures and maintaining a program to ensure state agencies' compliance with the State's purchasing laws and regulations.¹

In addition to these offices and divisions, the Department supports seven councils, boards, and committees that are subject to the State's open meeting law requirements. These public bodies fulfill various duties and purposes (see textbox). Auditors evaluated some of these public bodies for compliance with Arizona's open meeting law as part of the sunset factor analysis (see Sunset Factor 5, pages 11 through 12).

Duties of the department-supported public bodies subject to Arizona's open meeting law requirements

Governor's Regulatory Review Council—Reviews state agencies' rulemakings and evaluates state agencies' 5-year rule reviews.¹

Government Transformation Committee—Provides guidance and oversight to the Government Transformation Office, which assists state agencies with identifying, developing, sustaining, and measuring the performance of high-value process improvement projects.

Information Technology Authorization Committee—Reviews state-wide IT standards and the state-wide IT plan, and reviews and approves IT projects that exceed \$1 million.

Lease Cost Review Board—Estimates the average cost for leasing privately owned office space and recommends rental rates to the department director to be charged to state agencies for using space in state-owned buildings or buildings leased to the State.

Provider Indemnity Program Board—Communicates information and industry changes related to custodial care programs, including foster care, developmental disability programs, and independent living programs.

Set Aside Committee—Supports state agencies in their endeavor to purchase goods and services from designated state government or community sources. This committee reports quarterly to the Governor and the Legislature about these purchases.

Water Quality Appeals Board—Conducts hearings regarding appeals, and renders decisions between individuals and public or private entities who have been denied a permit by the Arizona Department of Environmental Quality.²

¹ Pursuant to A.R.S. §41-3017.05, the Governor's Regulatory Review Council sunsets on July 1, 2017.

² Pursuant to A.R.S. §41-3022.08, the Water Quality Appeals Board sunsets on July 2, 2022.

Source: Auditor General staff summary of Arizona Revised Statutes, Governor Executive Orders, and department information.

Budget

The Department's operating budget has increased gradually since fiscal year 2013. As shown in Table 1 on page 4, between fiscal years 2013 and 2015, the Department's total revenues increased from approximately \$1.1 billion to more than \$1.3 billion. Revenues primarily comprise charges paid by state agencies for department services, as well as State General Fund monies. The Department's total expenditures have also gradually increased. Between fiscal years 2013 and 2015, total

¹ For more information about the Department's procurement responsibilities, see Report No. 15-102, *Arizona Department of Administration—State-wide Procurement*.

Table 1: Schedule of revenues, expenditures, and changes in fund balance
Fiscal years 2013 through 2015
(In thousands)
(Unaudited)

	2013	2014	2015
Revenues			
Charges for services	\$ 965,743.1	\$ 1,054,813.9	\$ 1,085,521.1
State General Fund appropriations	113,961.2	159,270.6	165,565.1
Intergovernmental, including federal	20,392.8	41,320.0	34,862.5
Other	39,197.6	42,664.2	40,899.0
Total revenues	<u>1,139,294.7</u>	<u>1,298,068.7</u>	<u>1,326,847.7</u>
Expenditures and transfers			
Personal services and related benefits	77,976.9	83,267.9	85,157.1
Professional and outside services	43,859.5	49,624.8	53,713.7
Travel	361.7	324.0	331.3
Self-insurance claims	702,957.0	793,185.0	826,455.5
Other operating ¹	218,145.4	181,996.6	200,661.3
Equipment and other capital purchases	9,112.4	46,462.1	32,385.9
Total expenditures	<u>1,052,412.9</u>	<u>1,154,860.4</u>	<u>1,198,704.8</u>
Transfers to the State General Fund ²	30,044.4	68,309.8	53,976.6
Transfers to other agencies ³	25,089.5	35,629.4	52,246.1
Total expenditures and transfers	<u>1,107,546.8</u>	<u>1,258,799.6</u>	<u>1,304,927.5</u>
Excess of revenues over expenditures and transfers	31,747.9	39,269.1	21,920.2
Fund balance, beginning of year	<u>76,839.3</u>	<u>108,587.2</u>	<u>147,856.3</u>
Fund balance, end of year	<u>\$ 108,587.2</u>	<u>\$ 147,856.3</u>	<u>\$ 169,776.5</u>

¹ Amounts comprise various expenditures such as building rent and repair and maintenance costs.

² Amounts are primarily transfers to the State General Fund in accordance with Laws 2012, Ch. 294, §127 and Laws 2013, 1st S.S., Ch. 1, §125.

³ Amounts comprise transfers to other state agencies such as the Arizona Attorney General's Office for services performed for the Risk Management Division. In addition, the fiscal year 2014 amount includes \$15 million transferred to the State Land Trust Fund in accordance with Laws 2013, 1st S.S., Ch. 1, §110 and repayments of federal monies where the federal government determined the monies were inappropriately spent in prior years.

Source: Auditor General staff analysis of the Arizona Financial Information System (AFIS) *Accounting Event Transaction File* and the AFIS Management Information System *Status of General Ledger-Trial Balance* screen for fiscal years 2013 through 2015.

expenditures rose from nearly \$1.1 billion to nearly \$1.2 billion. The majority of expenditures are used to to pay medical, dental, and pharmacy claims for the State's self-funded health benefits plan. The other major expenditure category is other operating expenditures, which are used to cover costs such as building rent, telecommunications, and software support and maintenance. The Department's fund balance was approximately \$170 million as of fiscal year 2015.

SUNSET FACTORS

Sunset factor analysis

In accordance with Arizona Revised Statutes (A.R.S.) §41-2954, the Legislature should consider the following 12 factors in determining whether the Arizona Department of Administration (Department) should be continued or terminated.

Auditors found that the Department needs to make changes in two areas:

- Determine whether and when it can proceed with a rulemaking to address the requirements under A.R.S. §41-3532 for accessible information technology products and services (see Sunset Factor 4, pages 10 through 11); and
- Ensure that it consistently complies with the State's open meeting law requirements (see Sunset Factor 5, pages 11 through 12).

In addition to the recommendations in this report, the Department needs to address the recommendations directed to it in the other three audit reports issued as part of this sunset review (see Report Nos. 14-108, 15-102, and 15-108).

1. The objective and purpose in establishing the Department and the extent to which the objective and purpose are met by private enterprises in other states.

The Department was established in 1972 to provide centralized support services to state government by merging several previously established state agencies.¹ The Department provides various support services to Arizona state agencies and state employees, including:

- **Managing state personnel and their health and insurance benefits**—The Department manages the State Personnel System (System), which includes providing personnel services to state agencies in the areas of staffing and recruitment, classification and compensation, employee development, workforce planning and analysis, and operational support. As of June 2015, department data indicates that there were 105 state agencies and approximately 34,000 state employees in the System.² Additionally, the Department manages and administers state employees' health benefits and insurance programs, including offering medical, pharmaceutical, dental, vision, and life insurance coverage for active state and university employees, retirees, and their dependents. According to a department annual report, this coverage was extended to over 129,000 members during the 2014 calendar year.
- **Compensating employees for their work**—The Department calculates and processes payroll for all state agencies, except the universities. In fiscal year 2015, the Human Resources Information Solution system calculated employee payroll of approximately \$2.5 billion. This system also supports state agencies' and employees' ability to track salary, leave usage and balances, paychecks, and W-2 information.
- **Resolving claims against the State for property and liability issues**—The Department is responsible for investigating and settling all insurance claims related to state property and liability issues. The Department also consults with and advises state agencies to reduce the frequency and severity of losses in the areas of property, liability, environmental, and worker protection to reduce or eliminate their exposure to risk.

¹ The Arizona state agencies merged to create the Department were the Departments of Library and Archives, Public Buildings Maintenance, and Finance; the State Personnel and Historical Advisory Commissions; the Surplus Property Agency; and the Board of History and Archives.

² The System does not include the legislative and judicial branches of state government, the Arizona Department of Public Safety, or the universities.

- **Overseeing workers' compensation benefits for injured employees**—The Department administers workers' compensation benefits for state, university, and some Superior Court employees injured in the course and scope of their employment. Workers' compensation benefits, including lost wages, medical, surgical, and hospital disability benefits, are provided pursuant to A.R.S. §§23-901 through 23-1104. According to a department annual report, in fiscal year 2014, the State paid more than \$24 million in workers' compensation claims. The Department privatized the medical management administration component of the state workers' compensation program in 2015 (see Sunset Factor 12, pages 16 through 17).
- **Establishing and maintaining state accounting procedures and the state accounting system**—The Department establishes state-wide accounting policies and procedures and manages the state-wide accounting system. Specifically, the Department administers the *State of Arizona Accounting Manual*, which contains instructional materials as well as the State's central accounting policies and procedures. All state agencies are required to comply with these policies and procedures, unless otherwise authorized by law or exempted in writing by the department director. The Department also manages the State's accounting system and the Arizona Financial Information System, and provides technical assistance and other management advisory services.
- **Providing information technology services and support**—The Department oversees and provides information technology (IT) services and support, helping state agencies to conduct their work. The Department also sets state-wide IT policies and procedures, and oversees the State's telecommunications network.
- **Maintaining office buildings for employees to work in and a fleet to move them**—The Department provides property management services for over 4,000 state buildings and structures. Additionally, the Department is responsible for managing a state-wide vehicle fleet, which according to department data, included nearly 1,400 vehicles for use by state agencies for both short-term and long-term transportation needs as of July 2015.
- **Purchasing goods and services needed to conduct business**—The Department is the State's central procurement authority and has statutory responsibilities to procure and supervise state purchases of goods and services. The Department purchases goods and services for itself; delegates procurement authority to state agencies, which allows these agencies to procure goods and services up to their authorized purchasing amount without the Department's prior approval; and establishes state-wide contracts for use by state agencies and members of the Arizona State Purchasing Cooperative Program.¹ It also administers and oversees state agencies' compliance with Arizona's purchasing laws and regulations.

All 50 states have a state agency that delivers administrative support services to state agencies. According to the National Association of State Chief Administrators, a national professional organization, all 50 states have a state chief administrative office that

¹ Membership in the purchasing cooperative program is available to Arizona political subdivisions including cities, counties, and school districts. Membership is also available to nonprofit organizations, the federal government, and tribal nations.

delivers administrative or business functions on behalf of all other state agencies.¹ Auditors researched information about and contacted five other states for comparison, and found that the responsibilities of these states' administrative agencies varied.² For example, all five states' administrative agencies provided building management, risk management, and purchasing services to their states' agencies. However, two of these states maintained separate, although still centralized, IT offices, and three states maintained separate agencies responsible for overseeing state personnel.

2. The extent to which the Department has met its statutory objective and purpose and the efficiency with which it has operated.

The Department has generally met its statutory objective and purpose to provide centralized support services to state agencies, but can improve in some areas. Specifically, the Department:

- **Reviews vendor performance and monitors the costs of state employee health benefits contracts**—The Department awarded new health benefits and insurance contracts for calendar year 2015 without increasing state employees' premiums. Specifically, active state employees' medical benefits premiums have remained the same for calendar years 2011 through 2015, and dental plan premiums have remained the same for calendar years 2013 through 2015. In calendar year 2015, active state employees' vision premiums decreased and a new coverage tier was offered. Further, for calendar year 2016, the Department reduced active state employees' medical benefits premiums for two of the three coverage plans offered. The benefits and insurance programs that make up the state health plan include self-funded medical and dental plans; fully insured plans for dental, vision, basic life, supplemental life, dependent life, short-term disability, and long-term disability; and flexible spending accounts.³ The Department also manages a state-wide wellness program, which provides preventative health screenings, health management and health education courses, annual influenza shots, and online tools that are available to state employees as part of the benefits package.

The Department assesses state health plan vendors' compliance with contractual performance guarantees to help ensure that these vendors perform as expected. The Department includes performance guarantees, such as customer service and claims processing standards, in its medical benefits contracts and requires that state health plan vendors regularly report on their performance in these areas. If a state health plan vendor fails to meet performance guarantees during the year, the Department requires the vendor to prepare and submit a corrective action plan explaining how it will meet the required standard of performance. Following the end of the contract year, the Department assesses and collects financial penalties against those vendors that failed to achieve the performance guarantees. The Department reported that it collected more than \$300,000 in

¹ Campbell, P. & Snyder, M.E. (2011). State chief administrators: The lynchpins in state government reform. In *The book of the states 2011*. Lexington, KY: The Council of State Governments.

² Auditors selected states based on the states' expenditures, population, and the number of state employees. The states selected were Colorado, Kentucky, Louisiana, Minnesota, and Oregon.

³ A self-funded health plan, also known as a self-insured plan, refers to coverage provided by the organization seeking coverage for its members. Under this model, employer and employee contributions/premiums are pooled and used to pay claims, and the employer is financially responsible for covering all medical claims and administrative expenses. In contrast, under a fully insured plan, an organization pays a commercial insurer to provide the benefits specified in the insurance contract. The commercial insurer collects premiums, pays claims for services, and is financially responsible for covering claims and expenses.

calendar year 2013 from vendors who failed to meet performance standards during the 2012 calendar year, and estimates that it will collect more than \$210,000 in calendar year 2015 from state health plan vendors who failed to meet performance guarantees during the 2014 calendar year.

Additionally, the Department's internal auditors monitor state health plan members and their dependents' eligibility statuses, review the accuracy of state health plan vendors' claims payments and recover overpayments, and review external auditors' reports to help control benefit costs. Specifically, the Department annually conducts dependent eligibility audits to minimize the risk of paying claims on behalf of ineligible individuals. Department internal auditors also conduct reviews to help ensure that vendors accurately pay claims for eligible medical services and recover overpayments. For example, the Department reported that in 2013, internal auditors identified and collected overpayments that resulted from some state health plan vendors failing to adhere to benefits thresholds for hearing aids and durable medical equipment. Finally, department internal auditors review external audit report findings for state health plan vendors, which report on whether vendors' organizations and controls are suitably designed and operating effectively to ensure that claims are accurately processed.

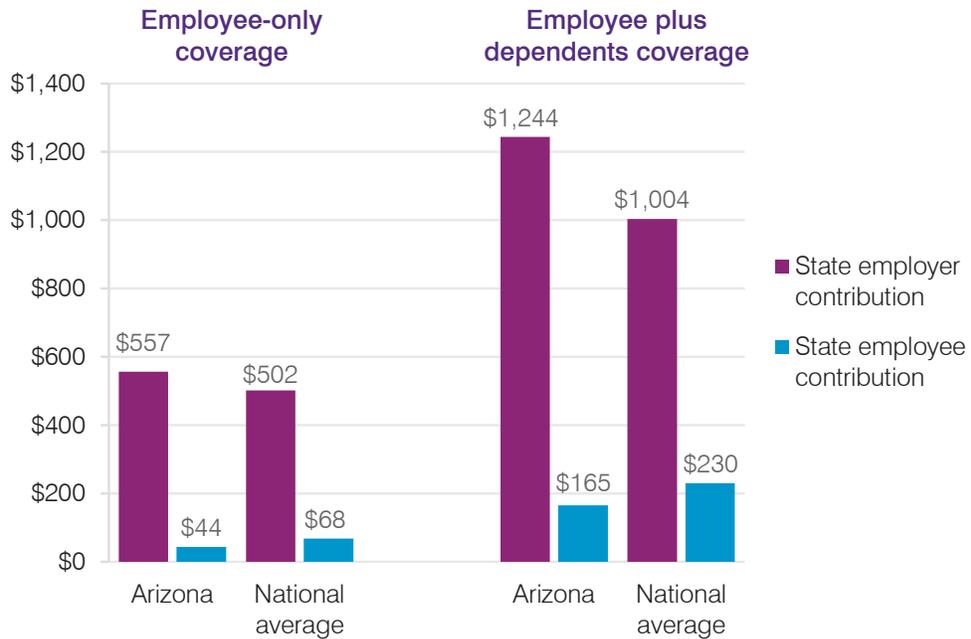
Finally, Arizona's average state health plan premiums were comparable to the national average in 2013, the most recent year for which comparative data is available. A report published by the Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundation in 2014 provides comparative data on the costs and characteristics of state employee health plans. As shown in Figure 1, page 9, Arizona state employees' monthly health plan premiums were slightly higher than the national average for two coverage tiers: employee-only coverage and employee plus dependents coverage. However, the State's contribution was also higher than the national average state employer contribution. As a result, Arizona state employees paid a lower premium amount on average for employee-only and employee plus dependents coverage than the national average. As part of the reductions to medical benefits premiums for 2016, the Department anticipates an overall shift in the proportion of premium contributions, which will result in a slight decrease in the percentage of the State's contribution and a slight increase in the percentage of state employees' contribution to the total premium.

- **Facilitates state agencies' process improvements and innovations**—Through its Government Transformation Office (Office), the Department enables state agencies to develop and sustain a culture of continuous improvement and innovation with an emphasis on service excellence and eliminating inefficient processes. The Office's 2014 annual report describes partnering with 9 state agencies to implement Lean solutions (see textbox for a definition of Lean). According to this report, these partnerships launched 24 continuous process improvement projects which, according to the Office, have resulted in these

Lean—A collection of principles and methods that focus on the identification of nonvalue-added activity. These principles and methods focus on reducing waste through continuous process improvement and empowering employees to evaluate and improve the processes they use.

Source: Auditor General staff summary of department documents and definitions in the United States Environmental Protection Agency. (2014). *Lean in government starter kit*. Washington, DC.

**Figure 1: Comparison of state employees' monthly health plan premiums contributed by employers and employees
Plan year 2013**



Source: The Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundation. (2014). *State employee health plan spending: An examination of premiums, cost drivers, and policy approaches*. Washington, DC.

state agencies' experiencing improved service delivery times to their customers and staff capacity to fulfill their agencies' missions in the areas that were reviewed. Further, the Office reported that it trained 132 employees from the Arizona Departments of Environmental Quality, Health Services, Revenue, and Transportation to lead future process improvement projects that address critical performance gaps in their respective agencies.

However, the performance audits completed as a part of the Department's sunset review also identified areas for improvement. Specifically, the Department should:

- Improve the assessment, collection, and protection of monies collected through the Arizona State Purchasing Cooperative Program**—The Office of the Auditor General's November 2014 report of the Arizona State Purchasing Cooperative Program (Program) found that the Department can improve its administration and management of the Program and program fee revenue (see Report No. 14-108). The Department established the Program in 1984, which allows members to purchase goods and services from state-wide contracts. Membership in the Program is available to Arizona political subdivisions including cities, counties, and school districts. Membership is also available to nonprofit organizations, the federal government, and tribal nations, as stipulated in statutes.¹

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

Although statute authorizes the Department to establish a program fee that covers the cost of administering the Program, the report found that the Department needs to better align the program fee with program costs. In addition, the Department needs to improve the collection of program fee revenue, and continue to strengthen its cash-handling controls over the processing of program fee revenue.

- **Strengthen its management, support, and oversight of the state-wide procurement system**—The Department is the State’s central procurement authority with responsibility to procure and supervise state purchases of goods and services. The Office of the Auditor General’s March 2015 report of the Department’s procurement function found that the Department can strengthen its role in the state-wide procurement system (see Report No. 15-102). Specifically, the report recommended that the Department strengthen its procurement strategic planning efforts, develop a comprehensive procurement policy and procedure manual, and further strengthen its oversight of state agencies’ procurements.
- **Complete personnel reform’s implementation and improve workforce planning**—As the State’s central human resources authority, the Department was responsible for implementing personnel reform, which the Legislature enacted in 2012. The Office of the Auditor General’s September 2015 report of the Department’s implementation of personnel reform found that although the Department had implemented key personnel reform provisions, it should complete its work in one area—updating the classification and compensation system, which encompasses the System’s job classes, pay structure, and job descriptions. Additionally, although not part of personnel reform, to address future workforce needs, the Department should develop a comprehensive internal workforce plan and take additional action to promote and strengthen workforce planning in the State (see Report No. 15-108).

3. The extent to which the Department serves the entire State rather than specific interests.

The Department is the administrative agency for the State and performs several state-wide support functions. As described in this report’s Introduction and in Sunset Factor 1, the Department’s primary responsibility is to support state agencies and state employees (see pages 1 through 7). For example, the Department’s Risk Management Division provides training courses to state agencies and state employees located throughout the State to reduce risks of harm to people and loss to property. Additionally, the Department supports the Arizona State Purchasing Cooperative Program, which provides cooperative procurement services to other governmental entities across the State, including local governments, political subdivisions, and the federal government (for more information about this program, see Report No. 14-108, *Arizona Department of Administration—Arizona State Purchasing Cooperative Program*).

4. The extent to which rules adopted by the Department are consistent with the legislative mandate.

The Department has statutory authority to promulgate rules. General Counsel for the Office of the Auditor General has reviewed the Department’s rulemaking statutes and believes

that, in general, the Department's rules are consistent with statute. However, General Counsel for the Office of the Auditor General identified one area in which the Department has not established statutorily required rules.

Specifically, the Department has not established statutorily required rules, a complaint procedure, or an undue burden process to implement federal and state IT accessibility laws. A.R.S. §41-3532 requires that IT services and equipment developed, procured, maintained, or used by state agencies with state monies provide comparable access to individuals with disabilities, in accordance with federal law. Additionally, this statute requires that the Department establish a complaint procedure for use by an individual with a disability who alleges that a state agency failed to comply with IT accessibility standards. Finally, state agencies are relieved of providing such accessible IT services and equipment if doing so would impose an undue burden. However, because of a moratorium on state agencies' rule making, the Department should determine whether and when it can proceed with a rulemaking to establish these required rules.

5. The extent to which the Department has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.

The Department encourages public input before adopting administrative rules, but it should take additional steps to ensure that it consistently complies with the State's open meeting law requirements. The Department has encouraged input from the public and stakeholders before adopting or amending its rules. For example, in August and September 2012, the Department requested and received written comments on its proposed rules applicable to its administration of the State Personnel System. Additionally, after requesting and receiving written comments addressing proposed changes to its procurement rules, the Department held oral proceedings in April and October 2014 to review the proposed rulemaking.¹ Additionally, in accordance with A.R.S. §41-1091.01, as of June 2015, the Department posted on its Web site the full text of each rule currently in use or the Web site address and location of the full text of each rule currently in use.

However, the Department should ensure that it consistently complies with the State's open meeting law. As described in this report's Introduction, the Department provides staff and support to several public entities that are subject to the State's open meeting law (see textbox on page 3). To assess these entities' compliance with open meeting law requirements, auditors reviewed a sample of public meetings held between September 2014 and March 2015. Although these public entities generally complied with the provisions of the State's open meeting law, auditors found two areas where the Department did not consistently comply with open meeting law requirements. First, auditors found that for three of the eight meetings reviewed, incorrect or conflicting information was provided on the posted meeting notice regarding the meeting's location or time. Second, auditors found that for three of the eight meetings reviewed, written minutes and/or meeting recordings were not available for public inspection until 5 to 9 business days after the meeting. According to A.R.S. §38-431.01(D), meeting minutes are to be available to the public within 3 business days. Additionally, department staff failed to post the meeting notice and agenda for the December 9, 2014, Information Technology Authorization Committee's meeting 24 hours in advance of the meeting.

¹ According to the Arizona Administrative Procedure Act (A.R.S. §41-1023), oral proceedings are conducted to afford a reasonable opportunity to persons to participate in the rulemaking process, and allow for adequate discussions of the substance and form of the proposed rules.

During the course of the audit, the Department took action to address this noncompliance. Specifically, as of April 2015, the Department had conducted training for appropriate staff on open meeting law requirements and, as of June 2015, it had developed desk references and meeting instructions for each of its public bodies subject to open meeting law requirements. Therefore, to help ensure that it consistently complies with the State's open meeting law requirements, the Department should continue to train appropriate staff, and monitor staff's actions to ensure that they adhere to these newly developed desk references and meeting instructions.

6. The extent to which the Department has been able to investigate and resolve complaints that are within its jurisdiction.

The Department is not a regulatory agency, and therefore, does not investigate and resolve complaints received from the public. However, statute provides the Department with the authority to address its employees' complaints under its personnel function, and protests under its procurement function. Specifically:

- **State personnel complaints and grievances**—All state agencies that are part of the State Personnel System are required to adopt discrimination and harassment complaint procedures for covered and uncovered employees, and a grievance procedure for covered employees.¹ The Department has adopted administrative rules defining the minimum requirements that these state agencies' complaints and grievances procedures must follow, and the associated time frames for resolving complaints and grievances. Rules also require that these state agencies submit their proposed complaint resolution procedure and any subsequent changes to the department director for approval.

As required by statute and rule, the Department has implemented an internal complaint procedure for department staff to report allegations of unlawful discrimination or harassment, and a grievance procedure for its covered employees. Specifically, department employees have 180 days to file a complaint of unlawful discrimination, harassment, retaliation, or intimidation. The Department's complaint coordinator is required to acknowledge receipt of the complaint in writing within 5 business days, complete its review and/or investigation of the complaint within 60 business days of receiving a written complaint, and forward a written recommendation to the department director within 10 business days of completing the review and/or investigation.² The department director is responsible for issuing a written decision to the complainant. A department employee may appeal the department director's decision within 5 business days of receiving the director's decision.³ The Department reported receiving

¹ Laws 2012, Ch. 321, §115, shifted a majority of the state workforce to at-will, uncovered status. According to A.R.S §41-741, at-will means an employment relationship where either party to the relationship may sever the relationship at any time for any reason other than an unlawful reason, such as harassment or discrimination. At-will employees are also referred to as "uncovered" employees. Certain state employees, including correctional officers and full authority peace officers, retained "covered" employment status, meaning they have the right to appeal dismissals, suspensions of more than 80 working hours, or involuntary demotion to the State Personnel Board or the Law Enforcement Merit System Council, respectively.

² Arizona Administrative Code R2-5A-902 also permits state agency complaint coordinators to request extensions to these time frames if extenuating circumstances exist.

³ State employees may appeal to the department director if they are not satisfied with their state agency director's decision. A department employee who is not satisfied with the department director's decision may re-submit his or her complaint to the department director for review and investigation by an individual who is not an employee of the Department and who serves in a position that is assigned to manage a state agency's employee relations.

one employee complaint in calendar year 2013, seven employee complaints in calendar year 2014, and two complaints in calendar year 2015, as of June 30, 2015. According to the Department, in all cases, the Department issued a response to the complainant within the time frame established in rule, or, if extended with the concurrence of the complainant, by the extended due date.

Additionally, rules require that each state agency adopt a grievance procedure that affords each covered employee a systematic means of resolving a disagreement with a disciplinary action. The Department reported that it did not receive any covered employee grievances from January 2013 through May 2015.

- **Procurement protests**—In accordance with the authority granted in A.R.S. §41-2612, the Department has adopted administrative rules addressing protested procurement solicitations and contract awards. Administrative rules permit any interested party to file a written protest against a solicitation, an agency chief procurement officer's decision that an offer is not qualified to be considered for award, or the award of a contract. According to rule, any agency chief procurement officer, including the Department's chief procurement officer, has 14 days to issue a written decision regarding how the protest will be addressed. However, the chief procurement officer may request an extension in writing from the department director. The following remedies are permitted under administrative rules if an agency's chief procurement officer sustains a protest: decline to renew the contract, terminate the contract, amend the solicitation, issue a new solicitation, award a contract consistent with procurement statutes and regulations, or provide other relief as determined necessary to ensure compliance with procurement statutes and regulations. Additionally, an interested party may file an appeal against the agency chief procurement officer's decision with the department director. According to department data, from fiscal years 2013 through 2015, the Department received 39 procurement protests.

7. The extent to which the Attorney General or any other applicable agency of state government has the authority to prosecute actions under the enabling legislation.

The Attorney General's Office serves as the Department's legal advisor and renders legal services as needed according to A.R.S. §41-192(A). For example, the Attorney General's Office defends the State against claims covered under A.R.S. §41-621. Additionally, according to A.R.S. §41-791.02, any lease purchase agreement related to land acquisition, capital projects, energy systems, or energy management systems must be reviewed and approved by the Attorney General for compliance with the State's constitution and laws prior to the agreement taking effect. Further, according to A.R.S. §41-2616(D), the Attorney General enforces the provisions of Arizona's procurement laws and regulations.

Additionally, the Department reported that it also uses outside counsel primarily for legal services required by the General Accounting Office to lease and finance state buildings; and the Risk Management Division, for the defense of the State, its entities, and employees as insured by the Department for or on account of their acts or omissions covered pursuant to law.

8. The extent to which the Department has addressed deficiencies in its enabling statutes that prevent it from fulfilling its statutory mandate.

According to department officials, the Department's enabling statutes contain no deficiencies that prevent it from fulfilling its statutory mandate. However, the Department's enabling statutes have undergone several changes since 2011 that have expanded the Department's duties and authorities, and changed the Department's structure. Specifically:

- **Laws 2014, Ch. 14, §2**—This law amended A.R.S. §41-3504, which now requires that state agencies procuring IT projects exceeding \$5 million contract with a third party for review of and guidance on the technology approach, scope, estimated cost, timeline for completion, and overall feasibility of the project. The Department still is required to evaluate and approve or reject all IT projects valued over \$25,000, and supports the Information Technology Authorization Committee, which reviews and approves IT projects that exceed \$1 million.
- **Laws 2013, Ch. 190**—This law made several changes to Arizona's procurement laws. These changes included restricting state employees classified as holding a "significant procurement role" from seeking employment with companies involved in procurement processes for 1 year, required the department director to establish and maintain a procurement compliance program and a mandatory procurement training and certification program to ensure consistent procurement practices for those authorized to perform procurement functions, and allowed the Department to establish procurement offices as determined necessary to allow it to effectively and efficiently administer the procurement program. The legislation also granted the department director rulemaking authority to address vendor performance and evaluate past performance.¹
- **Laws 2012, Ch. 321, §115**—This law made several changes pertaining to the structure, administration, and management of the State Personnel System (System). This legislation consolidated personnel systems within the executive branch; transitioned many state employees to at-will, uncovered status; defined the guiding principles for the management of the System; changed state employees' rights to complaints, grievances, and appeals processes; and defined the Department's duties and responsibilities for administering the System.²
- **Laws 2011, Ch. 27, §52**—This legislation transferred the functions of the Government Information Technology Agency to the Department, effective beginning in fiscal year 2012. These functions are now performed by the Department's Arizona Strategic Enterprise Technology Office.

¹ For more information about the Department's implementation of these statutory changes, see Report No. 15-102, *Arizona Department of Administration—State-wide Procurement*.

² For more information about the Department's implementation of these statutory changes, see Report No. 15-108, *Arizona Department of Administration—Personnel Reform Implementation*.

9. The extent to which changes are necessary in the laws of the Department to adequately comply with the factors listed in the sunset law.

The performance audits conducted as part of the Department's sunset review (see Report Nos. 14-108, 15-102, and 15-108) discussed one statutory change that the Department should pursue. Specifically, the Office of the Auditor General's September 2015 report on the Department's implementation of personnel reform recommended that the Department work with the Legislature to statutorily require state agencies to conduct workforce planning, due to the critical importance of workforce planning and the number of state employees who will become eligible for retirement in the next 5 years. In proposing this legislation, the Department should work with the Legislature to determine what workforce planning requirements should be addressed in statute, including how often state agencies should conduct workforce planning and specifying any review responsibilities. If statute is amended to require state agencies to conduct workforce planning, the Department should develop and implement policies and procedures that establish the requirements and guidance for the development of state agencies' workforce plans, including the minimum requirements for what these plans should include and the frequency with which state agencies should update their plans. Additionally, if statute is amended, the Department should periodically monitor state agencies' workforce planning efforts.

10. The extent to which the termination of the Department would significantly affect the public health, safety, or welfare.

As described in this report's Introduction, the Department was established to support state government operations (see page 1); therefore, terminating the Department would not significantly or directly affect the public health, safety, or welfare, but could result in inefficient and inconsistent state government operations. The Department provides various services to support state government, including administering state employees' health benefits and insurance programs, providing accounting and payroll services for state government, maintaining the office buildings state employees work in, and purchasing goods and services (see Sunset Factor 1, pages 5 through 7). Terminating the Department could result in losing efficiencies gained through having a centralized administrative services agency. For example, the Department, in accordance with A.R.S. §§38-651 through 38-671, manages and administers both statutorily required and elective health benefits and insurance programs for state and university employees, retirees, and their dependents, representing more than 129,000 members located throughout the State. Although state agencies could contract for and administer these benefits and insurance programs independently for their employees, it would be inefficient for them to do so, and would negate the cost savings the Department achieves by leveraging its state-wide buying power.

11. The extent to which the level of the regulation exercised by the Department compares to other states and is appropriate and whether less or more stringent levels of regulation would be appropriate.

This factor does not apply because the Department is not a regulatory agency.

12. The extent to which the Department has used private contractors in the performance of its duties as compared to other states and how more effective use of private contractors could be accomplished.

The Department accomplishes several of its duties through the use of private contractors. In fiscal year 2014, the Department spent an estimated \$898 million in state and federal monies for goods and services provided by private contractors. More than \$809 million, or 90 percent, of these monies were paid to 13 private contractors, and fell under four major categories: employee benefits, information technology systems, telecommunications, and building management and construction. Specifically:

- **Employee benefits**—The Department is responsible for the management and oversight of the State Personnel System, including providing employee health benefits. The Department’s Human Resources Division contracts for health, medical, pharmacy, dental, and vision benefits for state employees and their dependents. As part of the management of health benefits and the state health plan, the Department also contracts for consulting and actuarial services. In fiscal year 2014, the Department spent more than \$753 million on these contracts.
- **Information technology systems**—The Department contracts for software and system implementation and integration services for critical, state-wide information technology systems. For example, the Department is overseeing the replacement of the State’s financial and accounting system. Laws 2012, Ch. 294, appropriated a total of \$79.8 million from the State General Fund over 4 years, primarily for the replacement of this system. These monies cover the costs of the vendor’s contract, staffing, software licensing and maintenance, hardware, disaster recovery hosting, consulting fees, and contingency funds. Given the complexity of the project, the Department also contracted with a third-party consultant to assist in project planning, implementation, and vendor oversight. In fiscal year 2014, the Department spent nearly \$14.6 million on these contracts.
- **Telecommunications**—The Department serves as the central manager for information technology for the State, and contracts for goods and services such as networking equipment, state data center equipment and services, and telephone and Internet telecommunication services. In fiscal year 2014, the Department spent nearly \$7 million on these contracts.
- **Building management and construction**—The Department is responsible for the management of state buildings, and contracts for goods and services for state building management, which includes leasing, construction, operations, and maintenance costs. In fiscal year 2014, the Department spent more than \$34.6 million on these contracts.

The Department also has privatized other key responsibilities. For example, in calendar year 2012, the Department contracted with a third party to manage the coordination and provision of post-offer physical examinations for state employee job candidates who have

been made conditional offers of employment for jobs that may put them at risk of occupational illness or injury. The Department reported that it eliminated five occupational health positions through this privatization, and as a result, estimated saving more than \$230,000 annually. Additionally, as of May 2015, the Department has contracted with a third-party administrator to provide medical management services for the state workers' compensation program. These medical management services include "24/7" nurse triage; centralized injury reporting; a network of medical providers; scheduling and coordination of medical evaluations; and centralized bill payments. Based on a third-party actuarial analysis, the Department estimates that it will save a total of approximately \$2 million annually by privatizing the medical management administration component of the State's workers' compensation program.¹

Auditors contacted centralized administrative support services agencies in five states and found that the Department generally used contractors for similar goods and services as the agencies in these states.² For example, all of these states contract for some building management and construction goods and services. Most of these states contract for some telecommunications-related goods and services. Additionally, two states reported contracting for third-party administrators to manage their state workers' compensation programs and state employee health benefits programs.

The audit did not identify any other opportunities for the Department to use private contractors.

Recommendations:

1. Because of the existing moratorium on state agencies' rule-making, the Department should determine whether and when it can proceed with a rulemaking to establish the rules required by A.R.S. §41-3532 (see Sunset Factor 4, pages 10 through 11).
2. To help ensure that it consistently complies with the State's open meeting law requirements, the Department should continue to train appropriate staff, and monitor staff's actions to ensure that they adhere to the Department's newly developed desk references and meeting instructions (see Sunset Factor 5, pages 11 through 12).

¹ The Department retained a third-party actuary to analyze and compare the State's costs for administering the workers' compensation program to the third party administrator's program costs.

² Auditors contacted five other states selected as suitable for comparison to Arizona based on the states' expenditures, population, number of state employees, and the duties and responsibilities of their central administrative support agencies. The states were Colorado, Kentucky, Louisiana, Minnesota, and Oregon.

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) acting director and staff for their cooperation and assistance throughout the audit.

The Department's performance was analyzed in accordance with the statutory sunset factors. Auditors used various methods to address the sunset factors. These methods included gathering information on the Department's statutory duties and responsibilities; staff and vacancies; revenues and expenditures; and contracts. Auditors also reviewed applicable statutes and rules; information from the Department's Web site; information from the Department's fiscal years 2016 through 2020 strategic plan, and the Arizona Governor's Office of Strategic Planning and Budgeting's *Fiscal Years 2014-2016 Master List of State Government Programs*. In addition, auditors interviewed department management and staff.

Further, performance audit work related to the Department's administration of the Arizona State Purchasing Cooperative Program (see Report No. 14-108); its management, support, and oversight of the state-wide procurement system (see Report No. 15-102); and its implementation of personnel reform legislation enacted in 2012 (see Report No. 15-108) provided information for this report.

Auditors also used the following additional methods:

- To assess the Department's activities in relation to other states, auditors selected a group of states that were suitable for comparison based on the states' expenditures, population, number of state employees, and the duties and responsibilities of their central administrative support agencies. The states selected for comparative purposes were Colorado, Kentucky, Louisiana, Minnesota, and Oregon.
- To determine the State of Arizona's comparability to other states and the national average regarding state health plan premiums and how premium contributions were shared between the state employer and state employees, auditors reviewed and analyzed data included in a 2014 report published by the Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundation.¹ According to the authors, this report provides comparative data on the costs and characteristics of state employee health plans, and serves as a nation-wide benchmark against which states can be compared.
- To assess the Department's compliance with the State's open meeting law requirements, auditors tested a sample of public meetings held between September 2014 and March 2015 of entities that the Department provides staff and support to. Specifically, auditors reviewed information on the Department's Web site, interviewed department staff, and examined

¹ The Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundation. (2014). *State employee health plan spending: An examination of premiums, cost drivers, and policy approaches*. Washington, DC.

meeting documents including notices, agendas, and minutes related to 8 of the total 21 public meetings held in the time frame. Additionally, auditors attended and observed 6 of the 8 meetings.

- To assess the Department's use of private contractors, auditors compiled and analyzed unaudited expenditure data from the Arizona Financial Information System (AFIS) to determine the estimated amount of state and federal monies spent by the Department on goods and services in fiscal year 2014. Auditors then identified the private contractors who received approximately 90 percent of the monies spent by the Department in fiscal year 2014, and worked with the Department to identify the major categories that these private contractors' goods and services fell under.
- To obtain information for the report Introduction, auditors reviewed Governor Executive Orders and department-prepared documents relating to its responsibilities, functions, and staffing. Auditors also compiled and analyzed unaudited information from the AFIS *Accounting Event Transaction File* for fiscal years 2013 through 2015, and the AFIS *Management Information System Status of General Ledger-Trial Balance* screen for fiscal years 2013 through 2015.
- Auditors' work on internal controls focused on the Department's processes and procedures for controlling state employee health plan costs. Conclusions on this work are included in Sunset Factor 2, pages 7 through 10. Computerized system information was not significant to auditors' objective; therefore, auditors did not conduct test work on information system controls.

AGENCY RESPONSE

AGENCY RESPONSE

Douglas A. Ducey
Governor



Kevin Donnellan
Acting Director

ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

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August 31, 2015

Ms. Debra K. Davenport, CPA
Auditor General
Office of the Auditor General
2910 North 44th Street, Suite 410
Phoenix, AZ 85018

Re: Performance Audit –Sunset Review

Dear Ms. Davenport:

The Arizona Department of Administration (Department) has reviewed the draft of the recent Sunset Review of the Department provided by your office. As requested, the Department's written response is detailed below.

Recommendations:

1. Because of the existing moratorium on state agencies' rule-making, the Department should determine whether and when it can proceed with a rule-making to establish the rules required by A.R.S. §41-3532.

Agency Response:

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

2. To help ensure that it consistently complies with the State's open meeting law requirements, the Department should continue to train appropriate staff, and monitor staff's actions to ensure that they adhere to the Department's newly developed desk references and meeting instructions.

Agency Response:

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

Ms. Debra K. Davenport, CPA

August 31, 2015

Page 2 of 2

Thank you again for the opportunity to respond to your recommendations. We will continue to work with your office as we move toward our six month status update.

Sincerely,

Kevin Donnellan
Acting Director

Performance Audit Division reports issued within the last 18 months

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
15-102	Arizona Department of Administration—State-wide Procurement
15-103	Arizona Medical Board—Licensing and Registration Processes
15-104	Arizona Department of Transportation—Motor Vehicle Division
15-105	Arizona Department of Revenue—Use of Information Technology
15-CR1	Independent Review—Arizona's Child Safety System and the Arizona Department of Child Safety
15-CR1SUPP	Supplemental Report to the Independent Review—Arizona's Child Safety System and the Arizona Department of Child Safety
15-106	Arizona State Retirement System
15-CR2	Independent Operational Review of the Arizona State Retirement System's Investment Strategies, Alternative Asset Investment Procedures, and Fees Paid to External Investment Managers
15-107	Arizona Sports and Tourism Authority
15-108	Arizona Department of Administration—Personnel Reform Implementation

Future Performance Audit Division reports

Arizona Foster Care Review Board

