



A REPORT  
TO THE  
ARIZONA LEGISLATURE

Performance Audit Division

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Performance Audit and Sunset Review

# Arizona Office of Administrative Hearings

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September • 2014  
REPORT NO. 14-104



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Auditor General

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September 8, 2014

Members of the Arizona Legislature

The Honorable Janice K. Brewer, Governor

Mr. Cliff J. Vanell, Director  
Arizona Office of Administrative Hearings

Transmitted herewith is a report of the Auditor General, *A Performance Audit and Sunset Review of the Arizona Office of Administrative Hearings*. 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. I am also transmitting within this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Arizona Office of Administrative Hearings agrees with all of the findings and plans to implement all of the recommendations.

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

Sincerely,

Debbie Davenport  
Auditor General

Attachment

## REPORT HIGHLIGHTS PERFORMANCE AUDIT

## Office should enhance controls for ensuring fair, independent, and timely hearings

### Our Conclusion

The Arizona Office of Administrative Hearings (Office) was established in 1995 to ensure that the public receives fair and independent administrative hearings. The Office has implemented several controls to help ensure that it provides fair, independent, and timely hearings, but it should implement statutorily required training programs, enhance its policies and procedures for ensuring fair and independent hearings, and better comply with statutory hearing time frame requirements. Additionally, the Office's method for calculating the rates for its services results in inequitable agency charges, and the Office has further inflated these rates to make up for a shortfall in its State General Fund appropriation. To address these issues, the Office should implement a cost-based rate-setting method to develop consistent rates to charge all agencies for its services, and work with the Legislature to address its State General Fund appropriation shortfall.

The Office was established in 1995 to ensure fair and independent hearings. Most state agencies are required to use the Office for hearings, over which administrative law judges employed by the Office preside. Of the almost 7,600 hearings requested in fiscal year 2013, 74 percent came from the Arizona Health Care Cost Containment System (AHCCCS) with another 18 percent coming from four other agencies, including the Arizona Registrar of Contractors (ROC).

**Office should implement training programs and enhance policies and procedures**—The Office has implemented several controls to help ensure that it provides fair and independent hearings, including a supervising judge who provides daily oversight of and guidance to the Office's administrative law judges, assisting self-represented parties with the hearing process, requiring judges to assess agencies' reasons for modifying or rejecting judges' decisions, and ensuring that judges' interactions with hearing parties are perceived as independent and impartial. However, to comply with statute, the Office should implement training programs for agencies and judges. In addition, to further ensure that it provides fair and independent hearings, it should enhance some of its policies and procedures related to analyzing agency responses to hearing decisions, its ethical code, and soliciting feedback on its hearing processes.

**Office should better comply with statutory time frame requirements**—Statute requires the Office to hold hearings within 60 days of an appeal or an agency's request for a hearing, unless the parties mutually agree to a delay or a party shows good cause for a delay. The Office met the required time frames in more than 76 percent of its cases in the first 6 months of fiscal year 2014, but has not always required evidence that all parties have agreed to a later hearing date. The Office should schedule hearings more than 60 days after the hearing request only when it receives documentation that all parties have agreed to a later date, unless a party shows good cause for a postponement.

### Recommendations

The Office should:

- Develop and implement training programs for agencies and judges;
- Enhance some of its policies and procedures; and
- Schedule hearings more than 60 days after the hearing request only when it receives documentation that all parties have agreed to a later date, unless a party shows good cause for a postponement.

## Office should align rate-setting method with best practices

**Office should align its rate-setting method with best practices**—The Office used a complicated rate-setting method to ensure that it generated sufficient cash to pay its monthly expenses. The two components to the charges were an hourly rate for judge time and a charge for each hearing requested. However, this rate-setting method



2014

resulted in agencies paying different rates for the same services. For example, in December 2012, agencies paid between nearly \$68 an hour for one judge and nearly \$205 an hour for another judge, but in January 2013, the hourly rates agencies paid for these two judges were approximately \$80 and \$123, respectively. Additionally, the cost to request a hearing in March 2013 was approximately \$177 per hearing, while the cost in April 2013 was approximately \$116 per hearing.

These rate variations are inequitable because state agencies basically receive the same services from the Office. The Office reported that judges hear cases for a variety of agencies and that the amount and nature of work required to process a hearing request does not vary from case to case. We calculated the average rates that all agencies paid in fiscal year 2013 for judge time and hearing requests and compared these averages with what agencies actually paid during the fiscal year. Some agencies paid more and some less than if they had been charged the average rates. For example, the ROC paid about \$25,100 less than what it would have paid using the average rates, while AHCCCS paid about \$16,100 more. Additionally, the rate variations may jeopardize AHCCCS' compliance with federal regulations because it is not paying the same hearing rates as other agencies. Further, the Office's rate-setting method may not be clearly understood by billed agencies and requires complex rate-setting procedures that increase the risk of errors.

The Office should adopt a rate-setting method based on best practices. We reviewed fee-setting guidelines from several government sources, which indicate that the Office should calculate the total direct and indirect costs of providing services to determine user fees. Using this method, all users should pay the same fee for the same service. Another benefit of this method is that the Office could use its case management system for the accounting and billing, which currently is done manually.

**Office should take steps to address State General Fund appropriation shortfall**—State agencies that the State General Fund supports do not pay any charges for hearing services, and the Office receives a State General Fund appropriation that is supposed to cover the cost of those services. However, the Office reported that the appropriation has been insufficient to cover its hearing costs for these state agencies. Therefore, the Office annually determines the amount of the shortfall and adds an additional amount per hearing request and per hour of judge time to ensure it has sufficient monies to cover the shortfall. In fiscal year 2013, the ROC paid approximately \$41,000 and AHCCCS more than \$26,000 in additional charges to help cover the shortfall.

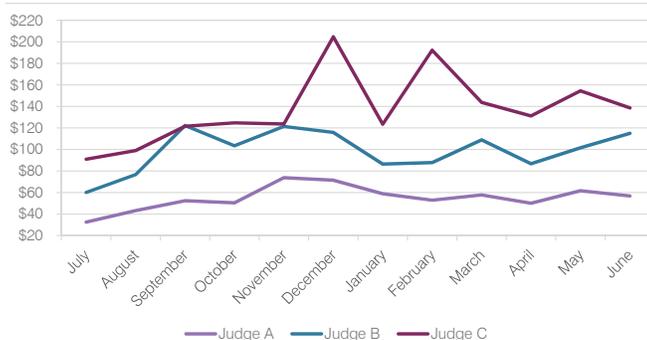
To address the State General Fund appropriation shortfall, the Office should determine whether it can charge some agencies it has previously not charged because the State General Fund no longer supports these agencies. The Office has already determined that the Arizona Department of Environmental Quality is one such agency and now charges it for hearing services. In addition, the Office should work with the Legislature on how to make up any continued State General Fund appropriation shortfall.

## Recommendations

The Office should:

- Align its rate-setting method with best practices, and
- Identify additional agencies that it can charge for its services and work with the Legislature to address any continued State General Fund appropriation shortfall.

## Examples of variations in the monthly rates charged per judge hour Fiscal year 2013



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# INTRODUCTION

## Scope and Objectives

The Office of the Auditor General has conducted a performance audit and sunset review of the Arizona Office of Administrative Hearings (Office) pursuant to an October 3, 2013, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq. This audit addresses the Office's internal controls for ensuring fair, independent, and timely hearings, and the Office's rate-setting method. It also includes responses to the statutory sunset factors.

# Arizona Office of Administrative Hearings

## Mission and responsibilities

The Office was established in 1995 to ensure that the public receives fair and independent administrative hearings. Prior to the Office's creation, individual state agencies, boards, and commissions provided administrative hearings to members of the public regarding appealable agency actions or contested cases (see textbox). Additionally, agencies' employees or contractors generally conducted hearings at their offices, which created a sense of "home court advantage" for the agencies. Thus, the Legislature created the Office to enhance public confidence in the fairness of the administrative hearing process. The Office commenced operation on January 1, 1996. Its mission is to "contribute to the quality of life in the State of Arizona by fairly and impartially hearing the contested matters of our fellow citizens arising out of state regulation."

**Appealable agency action**—An action an agency can take without first holding an administrative hearing to determine a party's legal rights, duties, or privileges. For example, a state regulatory board denying licensure is an appealable agency action that the regulatory board can take without an administrative hearing.

**Contested case**—An action an agency can take, but only after an opportunity for an administrative hearing to determine a party's legal rights, duties, or privileges. For example, a state regulatory board revoking or suspending licensure is an action that the regulatory board can make only after an opportunity for administrative hearing.

Source: A.R.S. §§41-1001(4), 41-1092(3), and 41-1092.11(B).

Statute generally requires state agencies to use the Office for administrative hearings unless statute specifically exempts it. For the most part, state agencies supported by the State General Fund are required to use the Office, while all other agencies are required to contract with the Office for its services. Statute exempts some agencies from this requirement, including the Arizona Department of Transportation, the Arizona Department of Corrections, the Arizona Board of Executive Clemency, and the Arizona State Personnel Board. Further, any agency director, board, or commission that directly conducts hearings as an administrative law judge is also not required to use the Office's services. Finally, the Office may enter into contracts with any state political subdivision to provide administrative hearings for that subdivision.

## Hearing process and requirements

Agencies must formally request administrative hearings from the Office. Within 7 days of the request, the Office is required by its administrative rules to provide agencies with the date and time of the hearing and the name of the assigned administrative law judge. If the parties do not settle the matter before the hearing date, an administrative law judge whom the Office employs conducts the hearing and writes a decision after the hearing concludes. Statute outlines several components of and requirements for the Office's hearing process, including:

- According to A.R.S. §41-1092.05, hearings must be held within 60 days of an appeal being filed for an appealable agency action or an agency's request for a hearing for a contested case, unless both parties agree to a postponement or one party shows good cause for a delay.<sup>1</sup> Although the Office notifies only the requesting agency of the scheduled hearing date and time, the requesting agency must notify the nonagency party of the hearing date at least 30 days in advance.
- The Office may schedule prehearing conferences, giving the parties and the judge an opportunity to conduct activities such as clarifying or limiting procedural, legal, or factual issues; exchanging lists of witnesses and exhibits; scheduling deadlines, hearing dates, and locations if not previously set; and discussing a possible settlement. If parties settle or if one party drops its dispute, the Office "vacates" the case, meaning the case is closed. Cases can be vacated before, during, or after a hearing.
- The Office cannot require hearing participants to have a lawyer or other representation.
- Hearings must be recorded, either electronically or using a court reporter.
- According to A.R.S. §41-1092.08, an administrative law judge must transmit a written decision to the agency within 20 days after a hearing concludes based only on the hearing record or any evidence noticed during the hearing. Additionally, the decision must include the judge's findings of fact and conclusions of law stated separately. It may also include a recommended agency action, such as a fine or other punitive action.
- Agencies generally issue the final decision in the case and have authority to accept, modify, or reject an administrative law judge's decision. If an agency rejects or modifies the decision, it must provide the Office a reason for doing so and write its own decision or modify the judge's decision accordingly. If an agency takes no position on the decision within 30 days of transmittal, the Office must issue the final decision. In a small number of case types, such as those for the Arizona Department of Revenue, the judge's decision is final according to state statute, and thus, the Office issues the final decision.
- In most cases, parties can request a rehearing. Additionally, most cases can be appealed to superior court.

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<sup>1</sup> The Legislature suspended the 60-day requirement for fiscal years 2010 through 2013, which the Office reported was because of reductions to its State General Fund appropriation. See page 4 for additional information about the Office's budget.

Hearings are generally conducted at the Office's location in Phoenix. Participants in Arizona Registrar of Contractors (ROC) cases may attend hearings by videoconference from various locations throughout the State, and participants in other cases may be allowed to attend hearings by telephone under certain circumstances. The Office also has a hearing room in Tucson that it reported is used for videoconferenced ROC hearings and can be scheduled for other hearings as needed.

## Hearing caseload

The Office reported receiving 7,596 requests for hearings in fiscal year 2013 from 41 state agencies, 3 county agencies, and 3 fire districts. However, approximately 92 percent of these requests came from the 5 state agencies listed in Table 1. According to the Office, the majority of cases concluded in fiscal year 2013 did not proceed to a full hearing because the cases were vacated. The Office reported that agencies responded to (i.e., accepted, modified, or rejected) 1,617 hearing decisions rendered by judges in fiscal year 2013, of which 1,378 were accepted, 206 were modified, and 33 were rejected (see Finding 1, page 6, for auditors' analysis of agencies' acceptance, modification, and rejection of decisions transmitted between November 1, 2010 and October 31, 2013). The Office also issued final decisions for an additional 185 cases that agencies did not respond to within 30 days during fiscal year 2013, as required by A.R.S. §41-1092.08.

**Table 1: Top five agencies requesting administrative hearings  
Fiscal year 2013**

| Agency                                      | Number of requests | Percent of total requests |
|---|--------------------|---------------------------|
| Arizona Health Care Cost Containment System | 5,647              | 74%                       |
| Arizona Registrar of Contractors            | 394                | 5                         |
| Arizona Department of Weights and Measures  | 389                | 5                         |
| Arizona Department of Health Services       | 354                | 5                         |
| Arizona Department of Economic Security     | 205                | 3                         |

Source: Auditor General staff analysis of information from the Office's fiscal year 2013 annual report.

## Staffing

The Office is led by a governor-appointed director. As of July 2014, the Office had 16.6 full-time equivalent (FTE) staff positions, including the director, an assistant presiding administrative law judge, 9 administrative law judges (8.6 FTE), an office manager, and 5 administrative support staff. One administrative support staff position was vacant as of July 2014.

# Budget

The Office's revenues consist primarily of State General Fund monies and charges for services. The Office receives a State General Fund appropriation that it uses to pay for services provided to state agencies supported from the State General Fund. As authorized by statute, the Office charges all other agencies or political subdivisions that it contracts with for its services (see Finding 2, pages 15 through 25, for additional information about the Office's rate-setting method). The Office calculates its charges for services to recover its expenditures without generating surplus net revenue. As a result, the Office's revenues are equal to its expenditures, and the Office does not carry a fund balance.<sup>1</sup> As shown in Table 2, the Office's revenues and expenditures were between \$1.85 million and \$1.95 million in fiscal years 2011 through 2014. Personnel costs accounted for the majority of the Office's expenditures in those fiscal years.

**Table 2: Schedule of revenues and expenditures and transfers  
Fiscal years 2011 through 2014  
(Unaudited)**

|  | 2011                | 2012                | 2013                | 2014                |
|--|---------------------|---------------------|---------------------|---------------------|
| <b>Revenues</b>                        |                     |                     |                     |                     |
| Charges for services                   | \$ 978,581          | \$ 1,000,119        | \$ 1,052,095        | \$ 1,072,825        |
| Appropriations:                        |                     |                     |                     |                     |
| State General Fund                     | 905,100             | 839,600             | 827,800             | 862,200             |
| Healthcare Group Fund                  | 14,500              | 14,500              | 13,300              | 12,300              |
| Charges for reproductions              | 1,634               | 614                 | 658                 | 1,117               |
| Total revenues                         | <u>\$ 1,899,815</u> | <u>\$ 1,854,833</u> | <u>\$ 1,893,853</u> | <u>\$ 1,948,442</u> |
| <b>Expenditures and transfers</b>      |                     |                     |                     |                     |
| Personal services and related benefits | \$ 1,440,037        | \$ 1,475,341        | \$ 1,550,489        | \$ 1,561,574        |
| Professional and outside services      | 17,315              | 14,460              | 16,559              | 17,388              |
| Travel                                 | 1,396               | 3,175               | 3,202               | 2,684               |
| Other operating                        | 398,554             | 317,477             | 315,757             | 318,808             |
| Equipment                              | 6,757               | 6,680               | 7,846               | 40,488 <sup>1</sup> |
| Total expenditures                     | <u>1,864,059</u>    | <u>1,817,133</u>    | <u>1,893,853</u>    | <u>1,940,942</u>    |
| Transfers <sup>2</sup>                 | <u>35,756</u>       | <u>37,700</u>       | <u></u>             | <u>7,500</u>        |
| Total expenditures and transfers       | <u>\$ 1,899,815</u> | <u>\$ 1,854,833</u> | <u>\$ 1,893,853</u> | <u>\$ 1,948,442</u> |

<sup>1</sup> According to the Office, equipment expenditures increased significantly in fiscal year 2014 because the Office is in the process of replacing its existing information system, including purchasing new hardware and software.

<sup>2</sup> The fiscal years 2011 and 2012 amounts consist primarily of transfers to the State General Fund in accordance with Laws 2010, 7th S.S., Ch. 1, §148 and Laws 2011, Ch. 24, §§108, 129, and 138, to provide support for state agencies. In addition, the fiscal year 2014 amount consists of a transfer to the Automation Projects Fund in accordance with Laws 2013, 1st S.S., Ch. 1, §127, to provide funding for the replacement of the State's financial information system.

Source: Auditor General staff analysis of the Arizona Financial Information System (AFIS) *Accounting Event Transaction File* for fiscal years 2011 through 2014 and the AFIS Management Information System *Status of General Ledger-Trial Balance* screen for fiscal years 2012 through 2014.

<sup>1</sup> The Office refunds any excess revenue collected to ensure that it does not carry a fund balance.

## FINDING 1

The Office of Administrative Hearings (Office) has implemented several controls to help ensure a fair, independent, and timely hearing process, but it can enhance these controls in some areas and should develop and implement training programs for agencies and office judges. Controls implemented by the Office include overseeing judges, reviewing and providing guidance for judges' hearings and decisions, limiting opportunities for inappropriate interactions between judges and case parties, and reviewing hearing decisions that agencies modify or reject. However, the Office should enhance these controls by revising its ethical code and policies and procedures, increasing its analysis of agency responses to hearing decisions, and revising its hearing evaluation form. Additionally, as statute requires, the Office should develop and implement training programs for agencies and office judges to further ensure it provides fair and independent hearings. Finally, although the Office generally meets timeliness requirements and standards for conducting hearings, it should take additional actions to better comply with these requirements.

## Office should enhance controls for ensuring fair, independent, and timely hearings

### Office can enhance some of its controls for ensuring fair and independent hearings

The Office has implemented several controls to help ensure that it meets its core function of providing fair and independent hearings, but it can enhance these controls in some areas. As discussed in the Introduction (see page 2), statute specifies several requirements regarding the hearing process, including adhering to proper hearing procedures and notification requirements. Additionally, the Office has implemented a number of policies and procedures to help ensure the appropriate conduct of hearings, judges, and its staff. Together, the requirements and procedures constitute a good set of controls, but in some cases, the Office can strengthen them. The controls and, where relevant, the steps the Office can take to improve them are presented below:

- **Oversight of judges**—The Office employs an assistant presiding administrative law judge (supervising judge) who supervises the Office's judges on a full-time basis. According to some office judges, the supervising judge provides daily oversight and guidance of judges through activities such as reviewing hearing decisions, monitoring live hearings, following up on any complaints about judges, and providing one-on-one guidance to judges. Additionally, the supervising judge and case management staff monitor judge timeliness using the Office's case management system. Further, the supervising judge also monitors compliance with policies using the Office's case management system, regularly tracks and logs the results of this monitoring, and uses this information in his formal performance evaluations of the judges.<sup>1</sup> For example, the supervising judge notes any instances of a judge's issuing a decision more than 20 days after a hearing conclusion, any agency modifications or rejections of hearing decisions that resulted from judge error, and any instances of a judge's failing to respond in a timely manner to a request from office staff for a case-file correction.<sup>2</sup>
- **Assistance to self-represented parties**—The Office provides assistance to self-represented parties to help ensure equal access to the hearing process. Arizona Revised Statutes (A.R.S.) §41-1092.07 allows all parties the right to represent themselves in a hearing. However, if parties lack

<sup>1</sup> The Office reported that, in 2013, it adopted the State of Arizona Managing Accountability and Performance system for employee evaluation and performance reviews.

<sup>2</sup> Office staff reported that they conduct regular audits for missing information in electronic case files, such as a missing notation from a judge that a hearing has concluded. When office staff discover missing information, they report that they send the judge a request for a case-file correction. The Office has a written policy requiring judges to make any requested corrections within 1 business day.

experience in judicial proceedings, they may be at a disadvantage compared to the agencies, which, according to the Office, are generally represented by an assistant attorney general. The Office publishes educational materials on its Web site that guide self-represented parties through the hearing process. For example, the Office’s Web site includes information on the hearing process, preparing and presenting expert testimony, filing motions, requesting a continuance, and what to expect once a hearing concludes. In addition, the Office has created videos to help parties prepare for hearings and that demonstrate activities such as cross examinations and making opening statements and closing arguments. Further, all of the Office’s judges who auditors interviewed reported that they take steps to ensure that self-represented parties understand and participate in the proceedings, including explaining the hearing process, asking clarifying questions of parties, and providing some leeway in hearing protocols.

- Requiring judges to review agency responses to decisions**—The Office has a process for reviewing agency rejections and modifications of hearing decisions to help ensure the fairness of case outcomes. As previously explained in the Introduction (see page 2), statute allows the agencies to accept, reject, or modify hearing decisions, but they must explain any modification or rejection. As shown in Table 3, agencies accepted the Office’s hearing decisions in the majority of cases auditors analyzed. If an agency either modifies the findings of fact and/or conclusions of law or rejects the decision outright, the Office requires its judge to review the agency’s response and to write a brief assessment of the agency’s reason for rejecting or modifying the decision. Additionally, the Office’s supervising judge reviews the agency’s response and rationale and the judge’s explanation.

**Table 3: Agency responses to hearing decisions  
November 1, 2010 through October 31, 2013**

| Response | Number of hearing decisions | Percent of total hearing decisions |
|----------|-----------------------------|------------------------------------|
| Accepted | 4,372                       | 83%                                |
| Modified | 75                          | 15                                 |
| Rejected | 98                          | 2                                  |

Source: Auditor General staff analysis of the Office’s case management data from November 1, 2010 through October 31, 2013.

The Office uses the information obtained from these reviews in several ways to help reduce errors and increase decision consistency. Although agencies modify or reject decisions for many reasons, in some cases, an agency’s action is in response to a judge’s error that could affect the appropriateness of the decision, such as judge omission of evidence presented in a hearing.<sup>1</sup> The Office tracks the number of judges’ errors as a performance measure for its judges’ performance reviews to help identify and rectify recurring or consistent errors. Additionally, the Office’s judges share information with each other from their reviews of decision modifications or rejections that they believe may be relevant to

<sup>1</sup> Agency representatives and office judges who auditors contacted reported that agencies modify or reject decisions for various reasons, including nonsubstantive changes to make minor corrections or improve clarity, taking into account evidence not presented during the hearing, interpreting the law in a different way than the judge, weighing evidence in a different way than the judge, and judge error. Auditors reviewed ten agency modifications and ten agency rejections of office decisions issued between November 1, 2010 and October 31, 2013, and found that the reasons listed in the agency responses and judge explanations were consistent with those that agency representatives and the Office’s judges reported.

other cases, such as court decisions that the other judges may not have been aware of. Further, the Office has revised its policies and procedures in response to information learned through the reviews to help ensure decision consistency. For example, the Office modified its policy regarding Arizona Registrar of Contractors cases to instruct judges to use the word “tender” only in regard to monetary transactions because the use of the word in other contexts—for example, to describe someone “tendering” a bid—was causing confusion. The Office reported that it made this change in response to review of agency responses to hearing decisions.

However, the Office can enhance its review of agency responses to hearing decisions by more fully analyzing this information. The supervising judge reviews each decision rejection and/or modification and records any judge errors that may have contributed to the decision’s rejection or modification in a database. However, according to the Office, beyond this case-by-case review, no broader analysis of errors is conducted. Periodically conducting further analysis of this information would allow the Office to potentially identify trends in judge error or bias that might not have been apparent in a case-by-case review, and that might warrant further inquiry. For example, if the Office found that a specific judge had a higher rejection rate in decisions for a particular agency, the higher rate might indicate an issue with the judge that should be addressed, such as training on particular laws or regulations related to the agency’s mandates and operations. Therefore, to identify trends in judge error or bias that might warrant further review and/or action, the Office should develop and implement policies and procedures for periodically analyzing agencies’ responses to hearing decisions.

- **Mandating appropriate conduct by judges and staff**—The Office has implemented controls for helping to ensure that judge interactions with parties and agency representatives are, and are perceived as, independent and impartial. For example, the Office has established an ethical code that prohibits communications between judges and a case party without all parties being present. The code warns against even engaging in communications unrelated to a case to avoid any appearance of impropriety. To help ensure that its judges are seen as independent from the agencies, the ethical code also prohibits judges from interacting with agency directors. Further, to limit the chance of unintentional communications between its judges and case parties, the Office’s e-mail system prohibits judges from receiving e-mails at their official office e-mail addresses from anyone besides office staff, and the Office reported that it does not publish judges’ office phone numbers. Finally, the Office has several written policies and procedures aimed at helping to ensure proper communications with parties. For example, the Office’s written procedures for administrative staff instruct them to log all phone calls and written correspondence regarding cases in the Office’s electronic case management system so that they become part of the case record.

However, the Office can further enhance its ethical code. Although the Office’s ethical code includes direction on inappropriate interactions between judges and parties to hearings, it does not include guidance on appropriate judge behavior in other areas. The National Association of Administrative Law Judges (NAALJ) has established a model code of ethics for administrative law judges.<sup>1</sup> This model code includes guidance related to conflicts of interest, such as financial and business dealings affecting a judge’s impartiality, and participation in outside activities,

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<sup>1</sup> *The Model Code of Judicial Conduct for State Administrative Law Judges* was adopted by the Board of Governors of the National Association of Administrative Judiciary (NAALJ) in 1993. NAALJ is a nonprofit organization established in 1974 whose core functions are (1) enhancing the quality of administrative justice and (2) furthering the process of alternate dispute resolution through arbitration and mediation.

such as freelance legal work or certain political activities. Although the Office's ethical code includes some standards requiring its judges to conduct themselves in ways that uphold the Office's impartiality and independence, more specific guidance would help judges determine appropriate and inappropriate behavior related to these standards. Similar to the NAALJ model code, the Office should expand its ethical code to include conflicts of interest, participation in outside activities, and other activities covered by the NAALJ model code that are relevant to the Office's judges.

- **External feedback on performance**—The Office solicits external feedback on its performance to help identify issues that may lead to unfair hearings, or the perception of unfair hearings. Specifically, prior to the hearing, the Office provides all hearing participants with an evaluation form. The evaluation form asks hearing participants to rate the Office as either poor, satisfactory, good, or excellent on nine hearing-related factors, including the judge's attentiveness, effectiveness in explaining the hearing process, use of clear and neutral language, impartiality, and effectiveness in dealing with the case's issues. The Office reported that nearly 400 people completed evaluations in fiscal year 2013, and more than 90 percent of these respondents rated the Office as good or excellent on all nine evaluation questions. Additionally, the Office has established a process for handling motions for change of judge and other complaints about its judges (see Sunset Factor 6, page 31, for more information about the complaint process).

The Office reported that it also holds regular meetings with some agencies to discuss potential improvements to its case management procedures, such as scheduling hearings and handling case documents. Further, in June 2014, the Office held two educational sessions on its electronic case management procedures for stakeholders, including agency staff and their assistant attorneys general, independent attorneys, and the general public. At these sessions, the Office asked attendees to complete a survey that included questions about judge conduct during hearings, the appropriateness and completeness of judges' decisions, and the customer service the Office's staff provided. The Office reported that 75 attendees completed the surveys, and less than 2 percent of respondents indicated any dissatisfaction with the Office's performance.

However, the Office can enhance its external feedback solicitation by revising its post-hearing evaluation process. For example, the Office distributes the evaluation form prior to the hearing before the judge issues the written decision on the case, and the evaluation does not address decision fairness, clarity, and timeliness. In addition, because it uses a paper evaluation form, the Office must manually enter evaluation responses into a spreadsheet to compile and analyze the data. To make its evaluation efforts as comprehensive as possible, the Office should add evaluation questions relating to decision fairness, clarity, and timeliness; review the timing of when it solicits evaluation feedback; and consider developing an electronic evaluation that either supplements or replaces the paper evaluation.

- **Other procedures aimed at ensuring fairness and independence**—The Office reported that it follows other procedures aimed at ensuring fair and independent hearings. For example, as explained in the Introduction (see page 2), in some cases, the Office issues a final decision rather than the requesting agency, either because statute requires it to do so,

or because the agency that requested the case does not take a position on the decision within 30 days. In cases where the Office issues the final decision, office staff reported that they always include language informing hearing participants that they have the right to appeal the decision, which is important for helping to ensure that all parties are informed of their rights. However, this and other procedures the Office reported are not included in the Office's written policies and procedures. To help ensure that office staff consistently and appropriately follow procedures designed to help ensure fair and impartial hearings, the Office should develop and implement written policies and procedures related to these informal procedures.

## Office should develop and implement training programs

A.R.S. §41-1092.01 requires the Office to establish training programs for agencies and its judges to help ensure that they comply with the Office's statutory requirements, many of which are related to ensuring fair and independent hearings. Although the Office does not have a formal training policy, as previously mentioned, the Office held two training sessions in June 2014 on its electronic case management procedures for stakeholders, including agency staff. The Office reported that it plans to continue holding periodic training sessions for stakeholders in the future, but it has not developed any formal plans or guidelines outlining how or when it will do so. Additionally, the Office reported that it previously had a policy that allowed judges to spend up to 40 hours of paid time annually for continuing education, but suspended this policy in calendar year 2008 because of decreased funding. The Office reported that it plans to reinstate the policy if resources allow. However, even if reinstated, the Office should improve upon the previous policy. For example, best practices suggest that an employee training program should provide appropriate training and include controls for ensuring that employees actually receive the required training, which the Office's suspended policy lacked.<sup>1</sup>

Therefore, the Office should develop and implement formal training programs for agencies and its judges. The training programs should include topics related to ensuring fair and independent hearings. Additionally, the Office should identify potential training topics for judges based on information obtained through some of its oversight and feedback procedures, such as supervisory review, external feedback on its performance, and review of agency responses to hearing decisions. Further, the Office should follow best practices by developing training policies for judges that establish factors such as minimum training requirements, guidelines for appropriate training received from outside sources, and documentation and oversight processes for ensuring that judges receive required training.

## Office's hearing process is generally timely, but it should better comply with statutory requirements

Although the Office has implemented various procedures for ensuring timely hearings and generally meets statutory requirements and other measures for timeliness, it should take actions to better

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<sup>1</sup> United States Government Accountability Office. (2001). *Internal control management and evaluation tool*. Washington, D.C.: Author.

comply with these requirements, such as ensuring that agencies follow proper procedures for requesting hearing dates. A.R.S. §41-1092.05 requires the Office to hold hearings within 60 days of an appeal being filed for an appealable agency action or an agency's request for a hearing for a contested case, unless the parties mutually agree to a later date or one of the parties shows good cause for a postponement. Additionally, A.R.S. §41-1092.08 requires the Office to transmit a written decision to the requesting agency within 20 days of a hearing's conclusion. The Office has implemented a number of procedures to help ensure that it meets these requirements. For example, the Office's case management system includes functions that allow staff and judges to automatically set reminders for deadlines of actions that need to be taken, such as scheduling hearings or transmitting decisions, and office staff and judges use these functions. Additionally, the supervising judge monitors judges' compliance with the 20-day requirement by running weekly queries for cases that have exceeded the requirement, notifying judges of the need to issue a decision, and reflecting missed deadlines in judges' performance reviews. Further, to provide information on the reasons for missed deadlines, the Office uses its case management system to track cases that exceed the 20-day requirement and reasons for the exceedances.

In its attempts to comply with the 60-day requirement for holding hearings, the Office also includes a step for checking that nonagency hearing parties receive ample notification as statute requires. A.R.S. §41-1092.05 requires the requesting agency to notify all case parties of the hearing date at least 30 days before the hearing. As a result, the Office must hold hearings at least 30 days after the agency notifies parties. The Office also reported that it conducts daily audits to identify any cases for which it has not received a hearing notice from the agency and contacts the agency to request that it issue the notice so that the Office can comply with this requirement.

Auditors' analysis of office data found that the Office is meeting its required time frames in most cases, but it should take some actions to better comply with statute.<sup>1</sup> Specifically:

- **Complying with the 60-day statutory requirement for holding a hearing**—As shown in Table 4 (see page 11), the Office held a hearing within 60 days for more than 76 percent of its cases in the first 6 months of fiscal year 2014.<sup>2,3</sup> In almost half of the cases that exceeded the requirement, the Office held a hearing within 70 days. The Office reported several reasons why some cases exceeded the 60-day requirement, including:
  - 181 cases exceeded the 60-day requirement because of a request or action by the requesting agency. Specifically, the agency either requested a specific date that was more than 60 days after the hearing request, specified limits on the dates when it would be available for hearings, made a blanket request that the Office schedule certain types of cases more than 60 days after the hearing request, or did not send out the hearing notice in a timely manner. As a result, the Office scheduled the hearing

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<sup>1</sup> Auditors assessed the Office's data system and access controls, and conducted other test work such as identifying any duplicate, blank, or nonsensical records, and determined that the Office's data was sufficiently valid and reliable for the purposes of this analysis.

<sup>2</sup> Although hearings for contested cases must be held within 60 days of an agency's hearing request, hearings for appealable agency actions must be held within 60 days of the notice of appeal. However, the Office does not handle or process the appeal notices, but instead receives these cases when it receives a subsequent hearing request from an agency. As such, the Office does not track the number of days between an appeal notice's filing and the agency request. Thus, auditors used the hearing request date in their analysis for both types of cases.

<sup>3</sup> The Legislature suspended the 60-day requirement for fiscal years 2010 through 2013. Thus, auditors' analysis of the Office's compliance with the 60-day requirement focused on the first 6 months of fiscal year 2014.

more than 60 days after the original request.

- o 145 cases exceeded the 60-day requirement because the Arizona Health Care Cost Containment System (AHCCCS) requested that the Office provide it with more processing time because of a large case backlog. AHCCCS staff confirmed that they had made such a request regarding the backlogged cases.

- o 43 cases exceeded the 60-day requirement because the Office did not have a judge available to hear the cases within 60 days.
- o 8 cases exceeded the 60-day requirement because the cases were complex and the Office wanted to give the parties more time to prepare for the hearings.

Auditors reviewed the Office's reasons for exceeding the 60-day requirement and determined that the Office's procedures for granting agency requests to hold hearings beyond the 60-day requirement need attention. Specifically, the only exceptions to the 60-day requirement permitted by A.R.S. §41-1092.05 are if the parties mutually agree to a later date or a party shows good cause for a postponement. A prehearing conference held within 60 days of a hearing request that determines a hearing date would also satisfy the statutory requirement. However, according to the Office, it does not require agencies to provide evidence that all parties have agreed to the hearing date when it schedules hearings beyond 60 days based on an agency's request. In addition, decisions to hold a hearing beyond 60 days should be made on a case-by-case basis rather than through a general request by an agency as was done for AHCCCS. Therefore, the Office should schedule hearings more than 60 days after the hearing request only when it receives documentation showing that all case parties have agreed to a later date, unless a party shows good cause for a postponement or in cases where it has held a prehearing conference, and it should make such decisions on a case-by-case basis.<sup>1</sup> Additionally, similar to its tracking of cases that exceed the 20-day requirement, the Office should use its case management system to track cases that exceed the 60-day requirement and reasons for the exceedances.

The Office should pay particular attention to meeting the 60-day requirement in cases involving appealable agency actions. Because these cases involve a nonagency party's appeal of an action that has already occurred, complying with an agency request to delay such a case without agreement from all parties or without requiring the agency to show cause and allowing other parties to respond can place an undue and unfair burden on nonagency parties. Conversely, in contested cases, although granting an agency request to delay the hearing without a show of cause does not comply with statute, the nonagency party is most likely not

**Table 4: Analysis of the Office's compliance with its 60-day hearing requirement July 1, 2013 through December 31, 2013**

| Number of days to hearing | Number of hearings | Percent of total hearings |
|---------------------------|--------------------|---------------------------|
| 0 to 60                   | 1,205              | 76.2%                     |
| 61 to 70                  | 184                | 11.6                      |
| 71 to 131                 | 193                | 12.2                      |

Source: Auditor General staff analysis of the Office's case management data from July 1, 2013 through December 31, 2013.

<sup>1</sup> Auditors also determined that the Office is allowed to exceed the 60-day requirement to help ensure that all case parties receive at least 30 days' notice of the hearing in cases where the agency fails to send out a hearing notice in a timely manner.

disadvantaged because the agency cannot generally take an action without first holding the hearing.

- **Complying with the 20-day statutory requirement for a decision**—As shown in Table 5, between November 2010 and October 2013, the Office transmitted nearly 97 percent of its judge decisions within 20 days of the hearing’s conclusion. Of the cases that exceeded the requirement, more than half were transmitted within 23 days of the hearing’s conclusion.

Another measure for timeliness, beside the 60-day and 20-day requirements statute mandates, is the amount of time required for completing the entire case from start to finish. Although not required to meet any overall administrative hearing timeliness standards, the Office surpasses national standards set for civil cases. Specifically, the National Center for State Courts has developed model time standards for state trial courts indicating that 75 percent of civil cases should be completed within 180 days, 90 percent within 365 days, and 98 percent within 540 days.<sup>1</sup> The Office surpassed these standards for hearings held between November 1, 2010 and October 31, 2013. Specifically, 97.6 percent of cases were completed within 180 days, 99.4 percent within 365 days, and 99.6 percent within 540 days.

**Table 5: Analysis of the Office’s compliance with its 20-day transmission requirement November 1, 2010 through October 31, 2013**

| Number of days to transmission | Number of decisions | Percent of total decisions |
|--------------------------------|---------------------|----------------------------|
| 0 to 20                        | 5,717               | 96.9%                      |
| 21 to 23                       | 97                  | 1.6                        |
| 24 to 65                       | 86                  | 1.5                        |

Source: Auditor General staff analysis of the Office’s case management data from November 1, 2010 through October 31, 2013.

## Recommendations:

- 1.1 To further enhance its policies and procedures for ensuring that it provides fair and independent hearings, the Office should:
  - a. Develop and implement written policies and procedures for:
    - Periodically analyzing agencies’ responses to hearing decisions to identify trends in judge error or bias that might warrant further review and/or action;
    - Providing additional guidance on judges’ ethical behavior to include conflicts of interest, participation in outside activities, and other activities the NAALJ model code of ethics covers that are relevant to the Office’s judges; and
    - All informal procedures it has established, such as informing hearing participants that they have the right to appeal a decision.

<sup>1</sup> Van Duizend, R., Steelman, D.C., & Suskin, L. (2011). *Model time standards for state trial courts*. Williamsburg, VA: National Center for State Courts.

- b. Add evaluation questions relating to decision fairness, clarity, and timeliness; review the timing of when it solicits evaluation feedback; and consider developing an electronic evaluation that either supplements or replaces the paper evaluation.
- 1.2 To comply with A.R.S. §41-1092.01, the Office should develop and implement formal training programs for agencies and its judges. These training programs should:
- a. Include topics related to ensuring fair and independent hearings;
  - b. Include policies for judge training that specify minimum training requirements, guidelines for appropriate training received from outside sources, and procedures for ensuring that judges receive the required training; and
  - c. Identify potential training topics for judges based on information obtained through some of its oversight and feedback procedures, such as supervisory review of judges, external feedback on the Office's performance, and review of agency responses to judges' decisions.
- 1.3 To ensure that it complies with statutory time frames for holding hearings, the Office should schedule hearings more than 60 days after the hearing request only when it receives documentation showing that all case parties have agreed to a later date, unless a party shows good cause for a postponement or in cases where it has held a prehearing conference, and it should make such decisions on a case-by-case basis. The Office should also use its case management system to track cases that exceed the 60-day requirement and the reasons for the exceedances. Additionally, in order to ensure that nonagency parties do not face undue or unfair burdens, the Office should pay particular attention to meeting the 60-day requirement in cases involving appealable agency actions.



## FINDING 2

The Office of Administrative Hearings (Office) should revise its rate-setting method to be consistent with best practices. The Office uses a cumbersome rate-setting method that results in agencies paying inequitable charges and other problems, such as jeopardizing another agency's compliance with federal regulations and a lack of transparency. In addition, since fiscal year 2010, the Office has increased the charges to some agencies to cover shortfalls in its State General Fund appropriation and the amount it bills to the Arizona Department of Fire, Building and Life Safety. To address these issues, the Office should align its rate-setting method with best practices by developing and implementing a cost-based rate-setting method, developing and implementing written rate-setting policies and procedures, and taking steps to address any continued shortfall between its State General Fund appropriation and the cost of services it provides to agencies the State Government Fund supports.

## Office should align rate-setting method with best practices

### Office's rate-setting method results in inequitable agency charges and other problems

The Office's rate-setting method, designed to provide sufficient cash for its operations on a month-to-month basis, results in inequitable charges assessed to agencies that use the Office's services, jeopardizing another agency's compliance with federal regulations, a lack of transparency, increased risk of errors, and cumbersome, labor-intensive procedures. As discussed in the Introduction (see page 4), the Office bills for the services it provides to state agencies that do not receive support from the State General Fund and other political subdivisions (agencies), including the Arizona Registrar of Contractors (ROC), state regulatory boards, local governments, and the Arizona Health Care Cost Containment System (AHCCCS) for some cases.<sup>1</sup> The Office bills these agencies (1) separate charges for each administrative law judge's time spent working on an agency's cases and (2) a charge for each hearing requested by an agency.<sup>2</sup> The Office calculates the rates for these charges monthly, which reflect its monthly expenditures, judge productivity, and caseload (see textbox, page 16). These inputs to the charges vary from month to month, based on such factors as the number of hours each judge worked on cases and the total number of hearings requested.

Because these inputs vary from month to month, the Office's rate-setting method results in rates that vary from month to month, both for judges and for hearing requests. Figure 1 (see page 16) shows the monthly variation in per hour judge rates the Office charged for three of its judges in fiscal year 2013. These rates varied from less than \$35 per hour to a high of more than \$200 per hour. Similarly, Figure 2 (see page 17) shows the monthly variation in the hearing request rate the Office charged in fiscal year 2013, which ranged from approximately \$105 to \$177 per hearing requested that year.

According to the Office, it designed this rate-setting method to ensure that it generates sufficient cash to pay its monthly expenditures regardless of caseload fluctuations. Most of the Office's expenditures—such as personnel costs and building rent—are fixed costs, many of which must be paid every month. However, demand for the Office's services can fluctuate from month to month. The Office reported that it cannot easily reduce its costs in response to

<sup>1</sup> Under an interagency service agreement between the Office and AHCCCS, the Office bills AHCCCS for a portion of the charges for Medicaid and KidsCare cases, and AHCCCS uses federal monies to pay for these charges.

<sup>2</sup> The Office also bills agencies for the actual cost of additional services needed for a specific case, such as interpreters or staff travel.

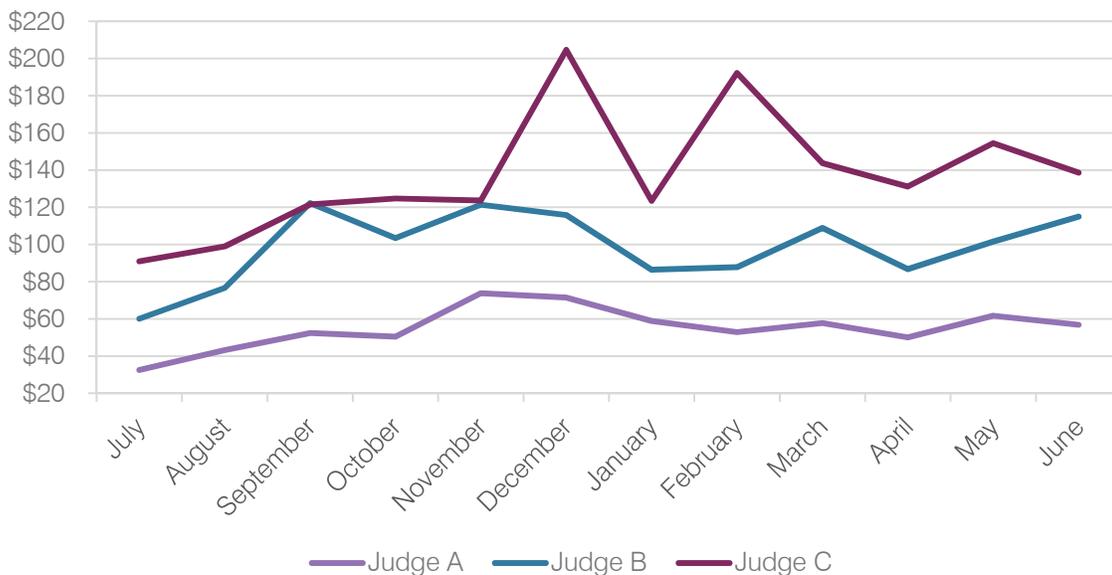
## Office method for calculating monthly billing charges

**Judge charges**—The Office charges agencies for the time judges spend on their cases. Each month, the Office calculates a separate hourly rate for each of its judges by dividing each judge’s monthly personnel costs, including salary and employee benefits, by the number of hours the judge worked on cases. For example, in December 2012, the Office charged a rate of nearly \$68 per hour for one judge who worked approximately 157 hours on cases that month and whose monthly personnel costs were approximately \$10,600. In that same month, the Office charged a rate of nearly \$205 per hour for another judge who worked approximately 39 hours on cases that month and whose monthly personnel costs were approximately \$8,000. These were the lowest and highest judge hourly rates charged that month. In comparison, the January 2013 hourly rates charged for these two judges were approximately \$80 and \$123, respectively.

**Hearing request charge**—The Office charges agencies for each hearing they request. Each month, the Office calculates a per hearing request rate by dividing its total monthly expenditures, excluding the judges’ personnel costs and actual cost of additional services needed for a specific case, by the number of hearings requested that month. These monthly expenditures include rent and utilities and personnel costs for administrative and management staff. For example, in March 2013, the Office charged a per hearing request rate of approximately \$177 based on approximately \$79,900 in expenditures and 451 hearing requests that month. In comparison, the April 2013 rate charged was approximately \$116 per hearing request.

Source: Auditor General staff analysis of office billing records for fiscal year 2013.

**Figure 1: Examples of variations in the monthly rates charged per judge hour  
Fiscal year 2013**



Source: Auditor General staff analysis of the Office’s billing records for fiscal year 2013.

decreased demand, such as by cutting staff, because if demand increased, it would not have adequate staff to meet its statutory requirement to provide hearings in a timely manner. Thus, the Office varies the rates it charges in response to fluctuations in demand to ensure that its monthly expenditures are met.

**Figure 2: Variation in the monthly rate charged per hearing request  
Fiscal year 2013**



Source: Auditor General staff analysis of the Office's billing records for fiscal year 2013.

Although this rate-setting method accomplishes the purpose of generating sufficient revenue, it presents a number of problems. Specifically:

- **Agencies pay inequitable rates for the same services**—As a result of the Office's rate-setting method, agencies pay different rates for the same services depending on the month in which they use the services and the judges assigned to hear their cases. For example, as shown in the textbox on page 16, agencies that had hearings in December 2012 would have paid between approximately \$68 per hour and \$205 per hour depending on which judge was assigned to the case. Similarly, an agency that requested a hearing in March 2013 would have paid approximately \$177 for the request, while an agency that requested a hearing in April 2013 would have paid approximately \$116 for the request, as shown in the textbox on page 16.

To determine the potential effect of these varying rates on agencies over the course of 1 year, auditors calculated the average hourly judge rate and the average per hearing request rate paid by agencies in fiscal year 2013.<sup>1</sup> The average hourly judge rate that agencies paid in fiscal year 2013 ranged from approximately \$63 per hour for the State of Arizona Office of Pest Management to approximately \$113 per hour for the Arizona State Board of Chiropractic Examiners (see Table 6 in Appendix A, page a-1).<sup>2</sup> Similarly, the average hearing request rate that agencies paid in fiscal year 2013 ranged from approximately \$97 per request for the Arizona State Board of

<sup>1</sup> Auditors calculated the average hourly judge rate each billed agency paid in fiscal year 2013 by dividing the total amount the agency paid for judge charges during the year by the total number of hours judges worked on cases for the agency during the year (see Table 6 in Appendix A, page a-1). Additionally, auditors calculated the average hearing request rate each billed agency paid in fiscal year 2013 by dividing the total amount the agency paid for hearing requests during the year by the total number of hearings the agency requested during the year (see Table 7 in Appendix A, page a-2).

<sup>2</sup> Average rates that condominium and planned community associations paid were excluded from the range of average charges listed because they pay only up to the amount the Arizona Department of Fire, Building and Life Safety (DFBLS) collects in fees. Statute requires DFBLS to establish a filing fee for hearings, and according to office management, the amount DFBLS has established is insufficient to pay the amount the Office billed. See page 21 for additional information.

Chiropractic Examiners to approximately \$158 per request for the Arizona State Board of Psychologist Examiners (see Table 7 in Appendix A, page a-2).

These rate variations are inequitable because they are not justified by any important differences in the services provided. Specifically, agencies received essentially the same services from the Office for each hour of billed judge time and each billed hearing request. Most of the Office's judges do not specialize in particular types of cases or cases for specific agencies, although the Office reported that some judges do have specialized expertise, education, or experience. The Office reported that it generally assigns cases to judges based on various factors, including availability, and each judge hears cases for a variety of agencies. Although the Office reported that services performed by judges may vary depending on the character and complexity of the case, which could justify potentially different hourly rates, the Office's billed hourly rates are not based on the complexity of the case, as discussed previously. Additionally, the Office reported that the amount and nature of work required to process a hearing request does not vary from case to case.

Further contributing to this inequity, although agencies can choose whether to use the Office's services, they cannot specifically choose specific elements of the Office's services. According to the Office, its rate-setting method provides "real-time pricing" because the monthly rates it charges reflect the supply of and demand for its services during the month. However, unlike in private markets, where consumers generally have free choice, agencies cannot choose the judges who hear their cases because, according to the Office, that could compromise the Office's independence. Similarly, although agencies can sometimes choose when to send cases to the Office, they do not know the cost up front and must instead wait until after the month is over to determine the cost they will pay, thus eliminating a free market choice.

To determine the potential effect of the Office's rate-setting method compared to a system that would have charged all agencies the same rates for services during the year, auditors calculated the average rate all agencies paid in fiscal year 2013 for the judge and hearing request charges the Office billed.<sup>1</sup> Auditors then compared the amount agencies actually paid to the amount they would have paid if they had paid the average rates. Some agencies paid considerably less than if they had been charged the average rate, while other agencies paid considerably more. For example, the ROC paid approximately \$25,100 less in charges in fiscal year 2013 than it would have if it had paid the average rates. Conversely, AHCCCS paid approximately \$16,100 more in charges during fiscal year 2013 than it would have if it had paid the average rates.

- **Varying rates may jeopardize AHCCCS' compliance with federal regulations**—As mentioned previously (see page 15), the Office bills AHCCCS for certain cases that are paid with federal monies. The Office has an interagency service agreement with AHCCCS, which serves as the basis for the charges the Office bills to AHCCCS. The agreement requires the

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<sup>1</sup> Auditors calculated the average hourly judge rate all billed agencies paid in fiscal year 2013 by dividing the total amount billed to agencies for judge charges during the year by the total number of hours judges worked on cases for the billed agencies during the year. The average rate was \$72.75 per hour (see Table 6 in Appendix A, page a-1). Auditors also calculated the average hearing request rate all billed agencies paid in fiscal year 2013 by dividing the total amount billed to agencies for hearing requests during the year by the total number of hearings the billed agencies requested during the year. The average rate was \$122.53 per request (see Table 7 in Appendix A, page a-2).

Office's charges for services it provides to AHCCCS to conform to federal regulations.<sup>1</sup> These regulations state that a cost included in billed rates is appropriate if it is applied uniformly to both the federal government and state government entities, and the costs are based on the relative benefits received. However, the varying rates the Office charged are based on factors other than the relative benefits received, such as its monthly expenditures, judge productivity, and caseload. As a result, the Office's billing method may be jeopardizing AHCCCS' compliance with federal regulations.

- **Office's rate-setting method may not be transparent to agencies**—The Office's rate-setting method may be unclear to some of its billed agencies. Specifically, two of the five billed agencies that auditors contacted did not have a clear understanding that the Office's judge rates varied from month to month. Additionally, auditors' review of office billing statements found that the statements did not list the actual rates charged.
- **Complex rate-setting procedures increase the risk of errors and lead to inefficiencies**—The Office's procedures for calculating its rates involve hundreds of manual inputs each month and complex spreadsheets with thousands of formulas. The Office reported that the spreadsheets were expanded and adapted over time to account for more complex situations. Given the spreadsheets' complexity and formulas, office staff reported that prior to fiscal year 2015, they were wary of changing the spreadsheets because the effects of the potential changes are not easily predicted or ascertained. As a result, office staff sometimes used workarounds rather than making changes to the spreadsheets, and these workarounds could obscure or distort some of the information contained in the spreadsheets. For example, the Office's calculation of monthly judge personnel costs for the per hour judge rate relied on the number of hours the judge was available to work during the month. However, even though one of the Office's judges worked part-time, office staff used full-time hours to calculate the judge's monthly personnel costs. Auditors determined that, in July 2012, the Office calculated \$400 more in personnel costs for the judge than if it had used part-time hours, resulting in an inaccurate higher hourly rate for the judge during that month. Additionally, the Office compares the number of hours a judge was available to work to the judge's hours billed to agencies to determine the judge's productivity. Auditors calculated that, by using full-time hours for the part-time judge, the Office overstated the judge's productivity for fiscal year 2013 by approximately 14 percent, making the judge seem much more productive than if it had used part-time hours.

The complexity of the Office's procedures also increases the risk of human errors because of the considerable number of manual inputs and formulas that office staff must track. For example, in fiscal year 2013, the Office's supervising judge began transitioning from spending most of his time hearing cases to supervising other judges. However, as his caseload decreased, office staff erroneously continued to bill his full personnel costs to the agencies for which he heard cases rather than allocate the cost of his supervisory duties through the hearing request rate as should have occurred under the Office's rate-setting method. For example, in June 2013, the Office billed more than \$680 per hour for his hearing services, nearly seven times the average charged for other judges. The risk of errors is further increased because the Office does not have written policies and procedures detailing its rate-setting procedures.

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<sup>1</sup> 2 CFR §225 outlines appropriate determination of costs for fees charged to the federal government by state, local, and tribal governments.

Finally, the complexity leads to inefficiencies. For example, using a large number of complex spreadsheets that the Office must update each month to calculate new rates requires more time than would a more straightforward or simpler billing approach. Beginning in fiscal year 2015, as a result of the audit, the Office reported that it has made substantial changes to the spreadsheets to reorganize, streamline, and simplify them.

## Billed agencies pay increased charges to cover funding shortfalls

In addition to the problems associated with the Office's rate-setting method, the Office increases its charges to some agencies in order to cover a shortfall in its State General Fund appropriation. This practice exacerbates the problems associated with the Office's rate-setting method. Further, the Office overestimates the increased charges and refunds excess revenue to agencies, but does not do so consistently. Additionally, the Office uses the increased charges to cover a shortfall in the charges that the Arizona Department of Fire, Building and Life Safety (DFBLS) paid for condominium and planned community association hearings.

**Office increases charges to some agencies to cover State General Fund appropriation shortfall**—As discussed in the Introduction (see page 4), the Office receives a State General Fund appropriation to pay for services it provides to agencies that the State General Fund supports. The Office does not bill or collect monies from these agencies. To determine its cost of services provided to these agencies, however, the Office uses the same rate-setting method previously discussed. According to the Office, calculating these rates and the cost of services for agencies that the State General Fund supports allows it to determine if its State General Fund appropriation is sufficient or whether it should request additional State General Fund monies. Based on its calculations, the Office reported that its State General Fund appropriation has been insufficient to cover the cost of services provided to agencies that the State General Fund supports since fiscal year 2010.<sup>1</sup> In fiscal year 2014, the Office requested a supplemental State General Fund appropriation for fiscal year 2014 and an increased appropriation for fiscal year 2015, but these requests were not granted. According to the Office, it did not request additional funding before fiscal year 2014 because it believed any requests would not be granted given the State's financial situation at that time, and because, at the time the shortfalls began, it was uncertain whether or not the shortfalls would continue.

To cover this shortfall, the Office determines an annual amount to recover from those agencies that it actually bills—that is, those agencies the State General Fund does not support. It then inflates both its judge and staff personnel costs by this amount, using the higher total to calculate the monthly per hour judge rates and the per hearing request rate. For example, in April 2013, the Office's inflation of personnel costs resulted in agencies paying an additional \$9.38 per hour for judge time and an additional \$16.03 per hearing request to cover the shortfall. Over the course of fiscal year 2013, these charges had a substantial impact on the

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<sup>1</sup> The Office reported that this shortfall has resulted from an increase in the relative caseload and complexity of cases from agencies supported by the State General Fund and a decrease in its State General Fund appropriation.

largest billed agencies. Specifically, in fiscal year 2013, the ROC paid approximately \$41,000 in additional charges to cover the shortfall, while AHCCCS paid over \$26,000.

The Office's practice of charging billed agencies to cover this shortfall exacerbates some of the previously mentioned problems related to the Office's rate-setting method, including putting AHCCCS at risk for noncompliance with federal regulations. These regulations state that billing rates used to charge federal monies should be based on costs for providing the service; therefore, federal monies should not be used to support any activity of state government. However, by charging billed agencies, including AHCCCS, to make up its State General Fund shortfall, the Office is out of compliance with its agreement and is jeopardizing AHCCCS' compliance with federal regulations. Making up the shortfall in this way also further impacts the rate-setting method's transparency. None of the five billed agencies that auditors contacted during the audit were aware that the Office was increasing their charges to partially cover the costs of providing hearing services to agencies that the State General Fund supports.

**Office overestimates increased charges but does not refund excess revenue to agencies consistently**—The Office intentionally overestimates the increase in rates that it charges to billed agencies to help ensure that it collects sufficient revenue to cover the shortfall. As a result, the Office generally collects more revenue than it needs to cover the shortfall, and it uses a complex process to refund the excess to billed agencies based on the amount of charges they paid during the year.<sup>1</sup> However, in fiscal year 2013, the Office did not provide refunds to the ROC or local governments, even though both paid the increased charges. According to the Office, it did not refund any excess revenue to the ROC because the ROC is the only billed agency that does not have an interagency service agreement with the Office that requires refunds. The Office reported that it did not refund any excess revenue to the local governments even though some have interagency service agreements that require refunds because its billing system is so complex that it could not practically design a method to calculate refunds for local governments in the time allotted to reconcile at the end of the fiscal year.

**Increased charges also cover funding shortfall for condominium and planned community association hearings**—In addition to the State General Fund shortfall, the Office makes up a second shortfall when it calculates the year-end refunds described above. Specifically, Arizona Revised Statutes (A.R.S.) §41-2198.01 requires petitioners in condominium and planned community association disputes to pay a filing fee to the DFBS in an amount that the DFBS director sets. Further, A.R.S. §41-2198.05 requires the DFBS to use the monies collected for filing fees to reimburse the Office for the actual costs of providing hearings for these disputes. However, according to the Office, the fee the DFBS has established has been insufficient to pay the full cost of services provided by the Office for these hearings since fiscal year 2012. As a result, the DFBS does not pay the full amount of the charges billed to it.<sup>2</sup> To make up this shortfall, the Office reduces the refunds it provides to billed agencies at the end of the year by the amount of the charges not paid by the DFBS. In fiscal year 2013, the Office reduced the total amount refunded to billed agencies by approximately \$9,000 to make up the charges the DFBS did not pay.

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<sup>1</sup> Although the Office is not prohibited from carrying a year-end fund balance, it reported that it refunds the excess revenue to billed agencies at the end of the fiscal year because it has interagency service agreements with the billed agencies that require it to do so, and it is practical to do so.

<sup>2</sup> The Office reported that in August 2012, it requested that the DFBS raise the filing fee, but the DFBS has not yet done so.

## Office should align its rate-setting method with best practices

The Office should align its rate-setting method with best practices for fee setting to address the previously identified issues, while also providing sufficient cash flow for operations. Although parts of the Office's process are consistent with best practices, such as charging a flat rate for hearing requests and an hourly rate for judges' time, other parts are inconsistent with recommended fee-setting guidelines.<sup>1</sup> Thus, the Office should align its rate-setting method with the following best practices:

- **Develop and implement a cost-based rate-setting method**—Best practices for government fee setting state that user fees should be determined by calculating the total direct and indirect costs of providing a service.<sup>2</sup> Under such a system, all users should pay the same fee for the same service. Additionally, in order to ensure equitable distribution of costs over time, best practices suggest that users of cost-based fee-setting methods should generally set fees based on a review of costs to provide the service and potential changes to the costs over time and should not alter them for at least 1 year, often longer. By contrast, the Office created its rate-setting method primarily to ensure that it has enough cash to operate on a monthly basis, resulting in agencies paying different rates for the same services. Thus, in order to help ensure that its agencies pay equitable rates for services, the Office should:
  - Develop and implement a cost-based rate-setting method that sets hearing request and judge time rates for at least 1 year at a time. Developing a cost-based rate-setting method would also allow the Office to better quantify its State General Fund shortfall because it would provide valid and reliable information on the costs of providing services to agencies that the State General Fund supports. Further, by charging the same rates for the same services, the Office reported that it could use its case management system for accounting and billing, which would streamline the billing process.
  - Examine the appropriate allocation of direct and indirect costs to its rates. For example, as stated previously, the Office allocates all of its expenditures except judge personnel costs and the actual costs of additional services needed for a specific case to its hearing-request charge. However, some of its expenditures could be considered indirect costs of providing judges' services, such as supervision of judges' case-related activities and administrative functions for cases that go to hearing or cases that are appealed. Best practices would support building these costs into the hourly rate for judge time. In addition, adding these costs to the hourly judge rate would allow the Office to better handle a varying caseload because it can likely predict fluctuations in judges' billed hours more easily than it can fluctuations in hearing requests. Best practices indicate that an agency should have a comprehensive cost accounting

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<sup>1</sup> Auditors reviewed fee-setting guidelines from the Arizona State Agency Fee Commission, the Government Finance Officers Association, the Mississippi Joint Legislative Committee on Performance Evaluation and Expenditure Review, the U.S. Government Accountability Office, and the U.S. Office of Management and Budget. See Appendix B, page b-1, for specific citations.

<sup>2</sup> Direct costs are those that are directly attributable to service provision, such as a judge's time spent working on a case, whereas indirect costs are those that multiple users share, such as building rent and information technology services.

system to obtain adequate information on the cost of services, and the Office has a system in place that it can use to provide this information.

- Use average costs to develop its rates. According to the U.S. Government Accountability Office, when differences in costs between users are low, using average costs to determine fees may be more efficient than determining actual costs, as the administrative cost of calculating actual costs may be prohibitive. Additionally, since most of the services the Office provides do not vary by agency, using average costs would help provide more equitable rates. Under its rate-setting method, the Office already takes this approach with some of its expenditures that it does not pay monthly—such as risk management insurance premiums and repair and maintenance expenditures—by spreading the expenditures evenly across all months of the year. The Office has already taken some steps in this direction. Beginning in fiscal year 2015, the Office reported that it modified its method for calculating its judge hourly rate so that a single hourly rate is calculated for all judges monthly. The Office should follow this same approach with other costs as appropriate.
- Set its rates high enough to handle fluctuations in caseload. Specifically, the Office's rates should be set so that it generates sufficient revenues during periods of high demand to build up enough cash reserves to cover its expenditures during periods of low demand.
- Continue seeking to reduce costs as much as possible. The Office has taken several steps to improve the efficiency of its operations, such as eliminating paper case documents, simplifying document exchange with agencies, and implementing electronic document submission for appeals (see Sunset Factor 2, pages 27 through 28). In developing its rates for services, the Office should continue to seek to reduce its costs to help ensure its rates are as low as possible.
- **Create rate-setting policies and procedures that include periodic review of rates, and consider ways to increase the method's transparency**—According to best practices, agencies' fee-setting processes should be transparent to service users and other stakeholders. Additionally, agencies should develop formal fee-setting policies and procedures that require a periodic review of fees. As discussed previously, agencies reported that they were not entirely aware of all aspects of the Office's rate-setting method. Further, although the Office had some documentation of its process, it lacked formal policies and procedures describing its process in full. Thus, in developing its rate-setting method, the Office should develop and implement formal, written rate-setting policies and procedures that include a requirement and procedures for the periodic review of rates. For example, the U.S. Office of Management and Budget requires agencies to review their fees biennially, whereas the Arizona State Agency Fee Commission recommended reviewing fees every 5 years. Additionally, to help ensure agencies understand their billed rates, when developing these policies and procedures, the Office should solicit input from agencies and publicize its policies, procedures, and rates on its Web site.
- **Take steps to address its funding shortfalls**—Best practices suggest government agencies should generally limit subsidizing services provided to one group of users with fees charged to another group of users.<sup>1</sup> The Office's practice of charging billed agencies to cover the costs of

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<sup>1</sup> Best practices suggest that subsidizing services for one group of users may be appropriate when the government wants to influence behavior, or when a certain group's usage provides benefits to the public. For example, an agency might subsidize community mental health services for lower-income individuals by charging higher-income individuals higher rates in an effort to avoid incurring the much higher costs of institutionalization at a later date.

services provided to agencies that the State General Fund supports and DFBS is not supported by best practice. Therefore, if the Office continues to have shortfalls in funding for the services it provides to agencies that the State General Fund supports and DFBS, it should take the following actions to reduce non-State General Fund agencies' subsidization of these services. Specifically:

- The Office should identify any additional agencies that it can charge for its services. Specifically, the State General Fund may no longer support some of the agencies the Office has not historically billed for its services. For example, beginning in fiscal year 2011, the Arizona Department of Environmental Quality (ADEQ) no longer received State General Fund appropriations, but the Office continued to treat ADEQ as a State General Fund agency through fiscal year 2014 because, according to the Office, it was unaware that ADEQ no longer received State General Fund monies. Additionally, in May 2014, the Office also reported that it learned that the State General Fund does not support the Arizona Department of Racing, which it historically had not billed for its services. Although these two agencies do not generally account for a large portion of the Office's caseload—combined they requested nine hearings and used approximately 400 hours of the Office's judge time in fiscal year 2014—the Office recognized that billing additional agencies that the State General Fund does not support would help reduce its State General Fund appropriation shortfall. As a result, as of June 2014, the Office entered into interagency service agreements with ADEQ and the Arizona Department of Racing that allow it to bill them in fiscal year 2015, and it was working to negotiate interagency service agreements for billing with two other agencies that it believes the State General Fund does not support.

To help it continue to identify such agencies in the future, the Office should develop and implement written policies and procedures to periodically review agencies' funding status. The Office should design these policies and procedures to allow it to identify any agencies it has been treating as State General Fund-supported agencies that may no longer receive State General Fund support, and to negotiate interagency service agreements with them if it determines it has the authority to do so.

- Once it has implemented a cost-based rate-setting method and can more accurately quantify the cost of services it provides to agencies that the State General Fund supports, the Office should work with the Legislature to clarify how it should address any continued shortfall between its State General Fund appropriation and the cost of services it provides to these agencies.
- The Office should work with the DFBS to ensure that the fee it charges for condominium and planned community association hearings is sufficient to pay for the charges the Office bills. Alternatively, the Office could work with the Legislature to change the way the fee for these hearings is determined. For example, once the Office has implemented a cost-based rate-setting method, it could request statutory authority to set the fee itself, or it could request statutory changes requiring the fee that the DFBS assesses for condominium and planned community association hearings to be the same as the Office's hearing rates.

## Recommendations:

- 2.1 To further align its rate-setting method with best practices, the Office should develop and implement a cost-based rate-setting method that sets rates for at least 1 year at a time. In developing the method, the Office should:
  - a. Examine the appropriate allocation of direct and indirect costs to its rates;
  - b. Develop rates using average costs;
  - c. Set its rates high enough to generate sufficient revenues during periods of high demand to build up enough cash reserves to cover its expenditures during periods of low demand; and
  - d. Continue seeking to reduce costs as much as possible.
- 2.2 To ensure a consistent rate-setting method, the Office should develop and implement formal, written rate-setting policies and procedures that include a requirement and procedures for the periodic review of rates. Additionally, when developing these policies and procedures, the Office should solicit input from agencies and publicize its policies, procedures, and rates on its Web site.
- 2.3 To address the State General Fund appropriation shortfall, the Office should:
  - a. Develop and implement written policies and procedures to periodically review the funding status of agencies. The Office should design its policies and procedures to allow it to identify any agencies it has been treating as State General Fund-supported agencies that may no longer receive State General Fund support and to negotiate interagency service agreements with them if it determines it has the authority to do so;
  - b. Once it has implemented a cost-based rate-setting method and can more accurately quantify the cost of services it provides to agencies the State General Fund supports, work with the Legislature to clarify how the Office should make up any continued shortfall between its State General Fund appropriation and the cost of services it provides to agencies the State General Fund supports; and
  - c. Work with the Arizona Department of Fire, Building and Life Safety to ensure that its fee for condominium and planned community association hearings is sufficient to cover the cost of services the Office bills, or work with the Legislature to change the way the fee for these hearings is determined.



## 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 it should continue or terminate the Arizona Office of Administrative Hearings (Office).

Auditors' analysis of the sunset factors found strong performance by the Office with regard to many of these factors, particularly in its efforts to increase efficiency by managing its cases electronically (see Sunset Factor 2, pages 27 through 28). Presented in the analysis is one recommendation that this report's earlier sections do not contain. It pertains to necessary improvements in cash handling, disbursement, and procurement practices (see Sunset Factor 2, pages 28 through 30).

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

The Office was established in 1995 to ensure that the public receives fair and independent administrative hearings. Prior to the Office's creation, individual state agencies, boards, or commissions provided administrative hearings to members of the public regarding appealable agency actions or contested cases. Additionally, agencies' employees or contractors generally conducted hearings at their offices, which created a sense of "home court advantage" for the agencies as compared to members of the public. Thus, the Legislature created the Office to enhance public confidence in the fairness of the administrative hearing process. The Office commenced operation on January 1, 1996. Its mission is to "contribute to the quality of life in the State of Arizona by fairly and impartially hearing the contested matters of our fellow citizens arising out of state regulation."

Auditors did not identify any western states that meet the Office's objective and purpose through private enterprises.<sup>1</sup>

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

The Office has generally met its statutory objective and purpose of providing fair and independent administrative hearings. Specifically, as discussed in Finding 1 (see pages 5 through 13), the Office has implemented a number of controls for ensuring the fairness, independence, and timeliness of its hearing process. For example, the Office employs a supervising judge who provides oversight to its judges to ensure they are following office policies. In addition, the Office provides assistance to self-represented parties through activities such as publishing educational materials on its Web site to help ensure the parties can represent themselves during hearings. Agencies generally accept the majority of its decisions, and the Office's hearing process is generally timely. Finally, the Office's judges review agencies' modification or rejection responses to their hearing decisions, and it uses the information obtained from these reviews in several ways to help reduce errors and increase decision consistency.

Additionally, the Office has taken several steps to improve its operations' efficiency. Specifically, the Office has:

<sup>1</sup> States auditors reviewed are California, Colorado, Idaho, Nevada, New Mexico, Oregon, Utah, and Washington.

- **Eliminated paper case documents**—The Office's case records and all related documents are stored electronically in the Office's case management system. According to the Office, without paper documents, the Office has reduced the time needed to process, maintain, and access documents, and it has reduced its need for storage space. Additionally, it has developed a process for more complex hearings in which all case parties and the assigned judge can access, submit, and exchange case documents through a Web-based portal, which the Office reported has reduced, and in some cases eliminated, the need for office staff to manage documents. Further, it has encouraged agencies and parties to submit documents electronically to reduce the amount of time staff must spend processing documents that are mailed or faxed to the Office.
- **Simplified document exchange with agencies**—The Office has developed secure, electronic document exchanges for agencies to receive transmitted hearing decisions. Two of the Office's biggest client agencies, the Arizona Health Care Cost Containment System and the Arizona Registrar of Contractors (ROC), also use the electronic document exchange to submit their final agency action on the hearing decisions back to the Office.
- **Implemented electronic document submission for appeals**—In fiscal year 2014, the Office worked with the Maricopa County Superior Court to allow electronic document submission for appeals. According to the Office, this change has eliminated the need to keep and maintain paper records for potential appeals, thus reducing the amount of time office staff must spend preparing documents for appealed cases.

However, auditors identified three areas for improvement. Two of these areas—the Office's controls for ensuring fair, independent, and timely hearings and its rate-setting method—were discussed in Finding 1 (see pages 5 through 13) and Finding 2 (see pages 15 through 25) of this report. The third area is presented here:

- **Office should improve its cash-handling, disbursement, and procurement practices**—The Office should continue developing and implementing policies and procedures to address longstanding control weaknesses for cash handling, disbursements, and procurement. Similar to a previous audit's findings, auditors found that the Office lacked several controls that the *State of Arizona Accounting Manual* requires and that are important for several reasons, including reducing the risk of fraud and theft and helping to ensure that management meets its intentions for spending public monies. Specifically, a 2001 Arizona Department of Administration's General Accounting Office (GAO) examination of the Office's internal controls found that the Office was not depositing cash receipts in a timely manner, and it was not adequately segregating duties for preparing, approving, entering, and releasing claims in the state accounting system, which potentially exposed the Office to risk of fraud and theft of state monies.

Auditors' review found that controls for cash handling, disbursements, and procurement were inadequate. As a result, the Office is limited in its ability to reduce the risk of fraud and theft and ensure that management meets its intentions for spending public monies. Specifically:

- The Office did not have adequate policies and procedures for separating cash-handling, disbursement, and procurement responsibilities and the associated record-keeping responsibilities among employees so that no one person had the ability to initiate and complete a transaction without independent review.<sup>1</sup> Specifically, one staff member handled most of the cash-handling, disbursement, and procurement responsibilities with no supervisory oversight or review, and also provided supervisory review for another staff member who handled some of these responsibilities. As a result, this one employee had complete control over the Office's cash-handling, disbursement, and procurement activities.

Additionally, GAO granted two office staff members full access to the state accounting system, allowing both employees complete control over vendor payments, employee travel payments, and automated electronic payments. As a condition for granting this access, GAO required the Office to implement procedures to help ensure that the employees used the access appropriately—such as providing supervisory review of each employee's transactions. However, the Office did not implement sufficient procedures to help offset the risk of inappropriate usage of the full access, despite agreeing in writing to do so.

- The Office did not have policies and procedures for employee use of purchasing cards and did not follow appropriate procedures for using the cards to reduce the risk of fraud and theft.<sup>2</sup> For example, in fiscal year 2013, office staff made \$6,925 in purchases from an unspecified vendor with office purchasing cards. Staff reported that these purchases were for painting office walls, but were unable to provide any supporting documentation for these transactions, such as vendor invoices or receipts.
- The Office did not have procurement policies and procedures to help ensure employees received proper bids for services and/or made payments to state-authorized contractors. For example, in fiscal year 2013, office staff paid approximately \$7,000 to a vendor for flooring without determining if this vendor was on state contract or obtaining approval from the State Procurement Office (SPO). Specifically, office staff stated that in fiscal year 2007, the Office purchased the same flooring with SPO's approval. However, the Office could not provide documentation supporting that it contacted the SPO in fiscal year 2013 to obtain approval to purchase the flooring. Additionally, the Office was required to request permission from the Arizona Department of Administration (ADOA) before performing any work on the state building it occupies, but it did not do so for either the flooring work or the painting described above.<sup>3</sup>
- The Office could not provide documentation that an office staff person had reviewed vendor invoice amounts to help ensure that payment amounts were accurate.

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<sup>1</sup> Cash-handling, disbursement, and procurement responsibilities include issuing payments, receiving monies, soliciting bids from and selecting vendors for services, and making deposits. For more information on the importance of adequate separation of responsibilities to help prevent fraud, see the Office of the Auditor General's Fraud Prevention Alert No. 14-402.

<sup>2</sup> Examples of fraud risks associated with the use of purchasing cards include the purchasing of personal items as well as unauthorized cash withdrawals. For more information on the fraud risks associated with purchasing cards, see the Office of the Auditor General's Fraud Alert No. 09-02.

<sup>3</sup> A.R.S. §41-791 establishes ADOA as responsible for maintenance and renovation of state office buildings, including the building occupied by the Office. According to ADOA, it may sometimes delegate authority for renovations to tenants, but not without prior ADOA review and approval of the scope of work proposed.

- The Office did not have adequate procedures for various aspects of its cash-handling practices. Specifically, all office staff had access to the cash box and cash log for cash payments, checks received for payments were not restrictively endorsed upon receipt to reduce the risk that unauthorized persons could cash the checks, and checks were not deposited in a timely manner to reduce the risk of theft. Additionally, the Office did not maintain prenumbered receipts for cash payments, which allows for the reconciliation of the cash deposited and helps to account for all monies received. As a result, the Office faced an increased risk that theft of public monies could occur and would potentially go undetected.

In May and June 2014, the Office revised its cash-handling and disbursement procedures and developed a new policy for employee use of purchasing cards. These changes addressed most of the deficiencies identified in this audit. However, the Office has not developed policies and procedures for procurement. In order to reduce the risk of fraud and theft and ensure management's intentions for spending public monies are met, the Office should continue implementing its new and revised policies and procedures and develop and implement policies and procedures to guide its procurement activities to help ensure these activities comply with procurement laws and regulations.

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

The Office has developed several strategies to serve all areas of the State. Specifically, the Office can provide administrative hearings to any state agency or local government in Arizona. Additionally, the Office can hold the hearings it conducts at its physical location in Phoenix, by telephone with prior administrative law judge approval, and through videoconferences in various locations throughout the State for ROC hearings. Further, the Office has a hearing room in Tucson that it reported it uses for videoconferenced ROC hearings and can schedule it for other hearings as needed.

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

General Counsel for the Auditor General has analyzed the Office's rule-making statutes and believes that the Office has established all of the rules required by statute and that established rules are consistent with statute.

**5. The extent to which the Office 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 Office has encouraged input from the public on its rules and informed the public of the expected impact of proposed changes to its rules. According to the Office, until fiscal year 2014, it had not adopted any rule changes since 1999, when its rules were first adopted. However, the Office solicited public input for rule-making activity in fiscal year 2014 when it proposed changes to its rules to conform them to a statutory change regarding judicial review of administrative proceedings. Specifically, on its notice of proposed rule-making,

the Office provided the name and contact information of the individual the public should contact to provide input to the proposed rule change. The Office reported that it did not receive any comments.

Further, the Office complies with A.R.S. §41-1091.01, which requires agencies to post on their Web sites the full text of each rule and substantive policy statement currently in use, and a notice that the substantive policy statement is advisory only.

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

The Office does not have explicit statutory authority or requirements to investigate complaints. However, statute allows case parties to file motions (1) requesting that the office director disqualify a judge from hearing a case based on bias, prejudice, personal interest, or lack of technical expertise, or (2) requesting a re-hearing. The Office has established written policies and procedures for addressing complaints made in conjunction with these motions, as well as any other complaints from the public involving the Office's judges. According to the policy, the director reviews all complaints. Additionally, the policy requires all complaints to be submitted in writing and states that the Office will provide all relevant parties with a copy of the complaint and give them an opportunity to respond as a matter of fairness so that the director may receive and consider all relevant information. The Office has posted a summary of its complaint-handling policy on its Web site.

**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.**

This factor does not apply to the Office because it is not a regulatory agency. However, the Attorney General is the Office's legal advisor and renders legal services as needed according to A.R.S. §41-192(A). The Office reported that it occasionally seeks legal counsel from the Attorney General's Office on various issues, such as a public record request or whether a particular agency response meets the statutory requirements for the agency's accepting, rejecting, or modifying the hearing decision.

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

According to the Office, there are no deficiencies in its enabling statutes that prevent it from fulfilling its statutory mandate.

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

The audit identified potential statutory changes the Office should address. Specifically, the Office should work with the Legislature to identify changes in its laws that may be necessary to address any funding shortfall in its State General Fund appropriation. Additionally, the Office could work with the Legislature to change the way that the fee for condominium and planned community association hearings is determined. For example, once the Office has implemented

a cost-based rate-setting method, it could request statutory authority to set the fee itself, or it could request statutory changes requiring the fee that the Arizona Department of Fire, Building and Life Safety assesses for condominium and planned community association hearings to be the same as its rates. (See Finding 2, pages 15 through 25, for more information.)

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

Terminating the Office would not significantly affect the public health, safety, or welfare. However, without the Office, there would not be an independent entity to provide administrative hearings. Instead, hearing officers who were either employees or contractors of the agencies whose actions were at issue would provide administrative hearings, as was the case before the Office was created. Having agency employees or contractors oversee hearings can create a sense of “home court advantage” in the agency, thus undermining public confidence in the fairness of the administrative hearing process. In addition, terminating the Office would result in losing any efficiencies gained through having a centralized hearing agency.

**11. The extent to which the level of regulation exercised by the Office 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 Office is not a regulatory agency.

**12. The extent to which the Office 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 Office has used private contractors for services such as interpreters, telecommunications services, legal research services, repair and maintenance of computers, office equipment, and case management software. Auditors contacted centralized hearing agencies in five western states and found that the Office generally used contractors for similar services as the agencies in these states.<sup>1</sup> However, agencies in three states—California, Oregon, and Washington—used private contractors to provide administrative law judge services for hearings. A.R.S. §41-1092.01 authorizes the Office to contract for temporary administrative law judge services only in the event that the Office cannot provide a judge promptly in response to an agency’s hearing request. As discussed in Finding 1 (see page 11), the Office was unable to provide a judge to hold a hearing within 60 days of an agency request in 43 cases during the first 6 months of fiscal year 2014. According to the Office, this small number of cases did not warrant contracting with a temporary administrative law judge, particularly given the cost of doing so.

The audit did not identify any additional areas where the Office should consider using private contractors.

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<sup>1</sup> Auditors contacted staff at administrative hearings agencies in California, Colorado, Nevada, Oregon, and Washington.

**Table 6: Schedule of average hourly judge rate paid  
Fiscal year 2013**

|  | Amount<br>paid for<br>judge<br>charges | Number<br>of hours<br>judges<br>worked<br>on cases | Average<br>hourly<br>judge<br>rate paid |
|--|--|--|---|
| <b>Agencies that paid under the average rate of \$72.75:</b>   |  |  |   |
| Condominium and planned community associations <sup>1</sup>    | \$ 13,217                              | 299.9  | \$ 44.07                                |
| State of Arizona Office of Pest Management                     | 282                                    | 4.5  | 62.67                                   |
| Arizona Registrar of Contractors                               | 269,011                                | 4,092.9  | 65.73                                   |
| Arizona Department of Housing                                  | 2,376                                  | 35.4   | 67.12                                   |
| Arizona State Board of Cosmetology                             | 627                                    | 8.8  | 71.25                                   |
| Arizona Medical Board  | 6,605                                  | 92.4   | 71.48                                   |
| <b>Agencies that paid above the average rate of \$72.75:</b>   |  |  |   |
| Arizona State Board of Nursing                                 | 24,804                                 | 340.9  | 72.76                                   |
| Arizona State Board of Accountancy                             | 10,628                                 | 145.4  | 73.09                                   |
| Arizona Peace Officer Standards and Training Board             | 10,476                                 | 141.1  | 74.25                                   |
| Arizona Board of Appraisal                                     | 901                                    | 12.1   | 74.46                                   |
| Arizona Department of Gaming                                   | 6,756                                  | 88.9   | 76.00                                   |
| Arizona State Board of Dental Examiners                        | 3,289                                  | 42.9   | 76.67                                   |
| Arizona Board of Osteopathic Examiners in Medicine and Surgery | 732                                    | 9.4  | 77.87                                   |
| Arizona State Lottery Commission                               | 623                                    | 8.0  | 77.88                                   |
| Arizona Health Care Cost Containment System federal programs   | 169,440                                | 2,050.4  | 82.64                                   |
| Arizona State Board of Technical Registration                  | 338                                    | 3.9  | 86.67                                   |
| Local governments  | 64,325                                 | 729.2  | 88.21                                   |
| Arizona State Board of Psychologist Examiners                  | 2,892                                  | 32.7   | 88.44                                   |
| Arizona Board of Behavioral Health Examiners                   | 10,347                                 | 113.9  | 90.84                                   |
| Arizona State Retirement System                                | 10,567                                 | 112.5  | 93.93                                   |
| Arizona State Board of Chiropractic Examiners                  | 893                                    | 7.9  | 113.04                                  |
| <b>Total all agencies</b>                                      | <b>\$ 609,129</b>                      | <b>8,373.1</b>                                     | <b>\$ 72.75</b>                         |

<sup>1</sup> Condominiums and planned community associations pay only up to the amount the Department of Fire, Building and Life Safety (DFBLS) collects in fees. Statute requires the DFBLS to establish the fee for the hearings, and according to office management, the amount established is not sufficient to pay the amount the Arizona Office of Administrative Hearings (Office) billed; therefore, the condominiums and planned community associations pay less than billed.

Source: Auditor General staff analysis of the Office's billing records for fiscal year 2013.

**Table 7: Schedule of average hearing request rate paid  
Fiscal year 2013**

|  | Amount<br>paid for<br>hearing<br>requests | Number of<br>hearings<br>requested | Average<br>hearing<br>request<br>rate paid |
|--|---|------------------------------------|--|
| <b>Agencies that paid under the average rate of \$122.53:</b>  |   |                                    |  |
| Condominium and planned community associations <sup>1</sup>    | \$ 1,583                                  | 19                                 | \$ 83.32                                   |
| Arizona State Board of Chiropractic Examiners                  | 193                                       | 2                                  | 96.50                                      |
| Arizona Department of Housing                                  | 103                                       | 1                                  | 103.00                                     |
| Arizona State Board of Cosmetology                             | 225                                       | 2                                  | 112.50                                     |
| Arizona State Retirement System                                | 1,586                                     | 14                                 | 113.29                                     |
| Arizona State Board of Accountancy                             | 2,693                                     | 23                                 | 117.09                                     |
| Arizona Medical Board  | 1,073                                     | 9                                  | 119.22                                     |
| Arizona Health Care Cost Containment System federal programs   | 346,177                                   | 2,859                              | 121.08                                     |
| Arizona Peace Officer Standards and Training Board             | 1,455                                     | 12                                 | 121.25                                     |
| Arizona State Board of Nursing                                 | 6,084                                     | 50                                 | 121.68                                     |
| Arizona Board of Osteopathic Examiners in Medicine and Surgery | 122                                       | 1                                  | 122.00                                     |
| <b>Agencies that paid above the average rate of \$122.53:</b>  |   |                                    |  |
| Arizona State Board of Technical Registration                  | 613                                       | 5                                  | 122.60                                     |
| Arizona Department of Gaming                                   | 624                                       | 5                                  | 124.80                                     |
| Arizona State Lottery Commission                               | 126                                       | 1                                  | 126.00                                     |
| Arizona Board of Behavioral Health Examiners                   | 511                                       | 4                                  | 127.75                                     |
| State of Arizona Office of Pest Management                     | 263                                       | 2                                  | 131.50                                     |
| Arizona Registrar of Contractors                               | 51,962                                    | 394                                | 131.88                                     |
| Local governments  | 12,119                                    | 90                                 | 134.66                                     |
| Arizona Board of Appraisal                                     | 2,082                                     | 14                                 | 148.71                                     |
| Arizona State Board of Dental Examiners                        | 310                                       | 2                                  | 155.00                                     |
| Arizona State Board of Psychologist Examiners                  | 315                                       | 2                                  | 157.50                                     |
| <b>Total all agencies</b>                                      | <b>\$ 430,219</b>                         | <b>3,511</b>                       | <b>\$ 122.53</b>                           |

<sup>1</sup> Condominiums and planned community associations pay only up to the amount the DFBSL collects in fees. Statute requires the DFBSL to establish the fee for the hearings, and according to office management, the amount established is not sufficient to pay the amount the Office billed; therefore, the condominiums and planned community associations pay less than billed.

Source: Auditor General staff analysis of the Office's billing records for fiscal year 2013.

## APPENDIX B

## 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 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 Office of Administrative Hearings' (Office) 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 the Office's statutes, rules, and policies and procedures; interviewing and/or observing office management, administrative law judges, and other staff; interviewing representatives from eight state agencies that use the Office's services; and reviewing information obtained from office staff or the Office's Web site.<sup>1</sup>

In addition, auditors used the following specific methods to meet the audit objectives:

- To assess the Office's internal controls for ensuring fair, independent, and timely hearings, auditors reviewed the Office's case management system, administrative law judge performance evaluation procedures, and hearing evaluation procedures, and observed two office hearings held on June 19, 2014. Auditors also reviewed internal control standards from the U.S. Government Accountability Office, standards for administrative law judge conduct from the National Association of Administrative Law Judiciary, model time standards for state trial courts from the National Center for State Courts, and other standards for administrative law judges.<sup>2,3,4,5</sup> Additionally, auditors conducted the following analyses:
  - Analyzed agency responses to hearing decisions between November 1, 2010 and October 31, 2013, to determine the number of decisions that agencies accepted, modified, and rejected, and reviewed 10 modified and 10 rejected hearing decisions and corresponding agency responses to determine reasons for agency modifications and rejections of hearing decisions;
  - Analyzed the Office's compliance with its 60-day hearing requirement for hearings requested between July 1, 2013 and December 31, 2013, and reviewed 40 of these cases to confirm the Office's explanation for why some hearings exceeded the 60-day requirement;<sup>6</sup>

<sup>1</sup> Auditors contacted representatives from the following state agencies: Arizona Board of Appraisal, Arizona Department of Economic Security, Arizona Department of Health Services, Arizona Department of Weights and Measures, Arizona Health Care Cost Containment System, Arizona Registrar of Contractors, Arizona State Board of Accountancy, and Arizona State Board of Nursing.

<sup>2</sup> United States Government Accountability Office. (2001). *Internal control management and evaluation tool*. Washington, D.C.: Author

<sup>3</sup> *The Model Code of Judicial Conduct for State Administrative Law Judges* was adopted by the Board of Governors' of the National Association of Administrative Judiciary (NAALJ) in 1993.

<sup>4</sup> Van Duizend, R., Steelman, D.C., & Suskin, L. (2011). *Model time standards for state trial courts*. Williamsburg, VA: National Center for State Courts.

<sup>5</sup> Mullins, M. E. (2004). Manual for administrative law judges. *Journal of the National Association of Administrative Law Judges*, 23(3), 1-183.

<sup>6</sup> The Legislature suspended the 60-day requirement for fiscal years 2010 through 2013. Thus, auditors' analysis of the Office's compliance with the 60-day requirement focused only on the first 6 months of fiscal year 2014.

- Analyzed the Office's compliance with its 20-day requirement for issuing hearing decisions for hearings requested between November 1, 2010 and October 31, 2013; and
  - Analyzed the Office's overall case timeliness for hearings requested between November 1, 2010 and October 31, 2013.
- To assess the appropriateness of the Office's billing process, auditors reviewed the Office's process in effect as of January 2014 and fiscal year 2013 billing records, including the information used to calculate hourly judge and per hearing request billed rates and formulas used in the billing spreadsheets. Auditors also conducted in-depth analysis of the Office's rate-setting method in its billing process, including recalculating fiscal year 2013 year-end adjustments; reconciling expenditures used for calculating billing rates to the Arizona Financial Information System (AFIS) for fiscal year 2013, transfers from other agencies and cash collections in the billing records to AFIS for fiscal year 2013, and billed hours and number of hearing requests to the Office's case management system for fiscal year 2013; comparing law judge hours on billing records to the State of Arizona Human Resource Information System for fiscal year 2013; analyzing monthly hourly and per-hearing request billed rates for fiscal year 2013; and calculating the average annual billed rates for fiscal year 2013 using the Office's billing records. Additionally, auditors interviewed and observed office staff performing the billing process and interviewed officials from five state agencies that were billed for services in fiscal year 2013, and reviewed best practices for fee setting from the Arizona State Agency Fee Commission, the Government Finance Officer's Association, the Mississippi Joint Legislative Committee on Performance Evaluation and Expenditure Review, the U.S. Government Accountability Office, and the U.S. Office of Management and Budget.<sup>1,2,3,4,5,6</sup>
  - To obtain information used in the Introduction section of the report, auditors compiled and analyzed unaudited information from the AFIS *Accounting Event Transaction File* for fiscal years 2011 through 2014 and AFIS Management Information System *Status of General Ledger-Trial Balance* screen for fiscal years 2012 through 2014. In addition, auditors reviewed information from the Office's organizational chart, its fiscal year 2013 annual report, and legislative staff's 2004 sunset review of the Office.
  - To obtain information used in the sunset factors, auditors:
    - Assessed the Office's internal controls for cash handling, disbursements, and procurement by reviewing the Office's policies and procedures in effect as of January 2014 and as revised in May and June 2014; reviewing prior internal control reviews conducted by the Arizona Office of the Auditor General and Arizona Department of

<sup>1</sup> Arizona State Agency Fee Commission. (2012). *Arizona State Agency Fee Commission report*. Phoenix, AZ: Author.

<sup>2</sup> Michel, R.G. (2004). *Cost analysis and activity-based costing for government*. Chicago, IL: Government Finance Officers Association.

<sup>3</sup> Joint Legislative Committee on Performance Evaluation and Expenditure Review (2002). *State agency fees: FY 2001 collections and potential new fee revenues*. Jackson, MS: Author.

<sup>4</sup> U.S. General Accountability Office. (2008). *Federal user fees: a design guide* (GAO-08-386SP). Washington, DC: Author.

<sup>5</sup> U.S. Office of Management and Budget (2004) *OMB Circular A 87*. Washington, DC: Author.

<sup>6</sup> U.S. Office of Management and Budget (n.d.) *OMB Circular A 25 Revised*. Washington, DC: Author.

Administration General Accounting Office; interviewing and observing staff responsible for financial operations; judgmentally selecting and testing 16 fiscal year 2013 payments for appropriateness, including all 11 purchasing card transactions; and reconciling transfers from other agencies and cash collections in the billing records to the AFIS for fiscal year 2013.

- Reviewed the *Arizona Administrative Register* and the Office's March 2014 proposed rule changes;
  - Reviewed literature on the potential benefits of having a centralized hearing agency;
  - Reviewed state laws from eight western states to determine the extent to which the Office's objective and purpose are met by private enterprises in other states, and contacted staff at administrative hearing agencies in five of these states to determine their use of private contractors.<sup>1</sup>
- Auditors' work on internal controls included assessing the Office's controls for ensuring fair, independent, and timely hearings, and assessing accounting controls for billing, cash handling, disbursements, and procurement. Auditors' conclusions on these internal controls are reported in Finding 1, Finding 2, and Sunset Factor 2. In addition, auditors conducted data validation work to assess the reliability of the Office's case management database information used to assess the Office's compliance with statutory time frames for holding hearings and issuing hearing decisions and agencies' responses to hearing decisions. Specifically, auditors reviewed the Office's policies and procedures, interviewed and observed office staff, interviewed the independent contractor who oversees the Office's data security controls, tested database access controls on office computers, observed physical security controls, reviewed data quality procedures, and analyzed data for blank, duplicate, and nonsensical data entries. Auditors determined that the Office's database was sufficiently reliable for the purposes of the audit.

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<sup>1</sup> Auditors reviewed statutes from California, Colorado, Idaho, Nevada, New Mexico, Oregon, Utah, and Washington. Auditors contacted staff at administrative hearings agencies in California, Colorado, Nevada, Oregon, and Washington.

# AGENCY RESPONSE

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# Office of Administrative Hearings

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Telephone (602)-542-9826 FAX (602)-542-9827

Janice K. Brewer  
Governor

Cliff J. Vanell  
Director

August 27, 2014

Debra K. Davenport, CPA, Auditor General  
Office of the Auditor General  
State of Arizona  
2910 N. 44<sup>th</sup> Street, Suite 410  
Phoenix, Arizona 85018

Dear Ms. Davenport,

The Office of Administrative Hearings (Office) has reviewed the report of the Auditor General, "*A Performance Audit and Sunset Review of the Arizona Office of Administrative Hearings*" (Report No. 14-104, hereinafter referred to as "Report"), and responds as outlined below.

## **Introduction:**

The Office has extracted and responded to each finding and each recommendation found in the Report, incorporating the appropriate statement to comply with the Joint Legislative Audit Committee's procedures.

It is the goal of the Office to fulfill its mission of providing full, fair, impartial, independent, and timely hearings to the highest level that it can attain. The Office has found the field work of the Office of the Auditor General in preparation of its Report to have been extremely beneficial to that end. Throughout the process, the Office has found the auditors assigned to it to have been thoroughly professional in their approach, and in response, the Office has already implemented improvements and refinements. The Office embraces the findings and recommendations of the Report to which it now responds as a continuation of that process.

## **Finding 1**

"The Office of Administrative Hearings (Office) has implemented several controls to help ensure a fair, independent, and timely hearing process,



**Mission Statement:** We will contribute to the quality of life in the State of Arizona by fairly and impartially hearing the contested matters of our fellow citizens arising out of State regulation.

but it can enhance these controls in some areas and should develop and implement a training program for agencies and office judges. Controls implemented by the Office include over seeing judges, reviewing and providing guidance for judges' hearings and decisions, limiting opportunities for inappropriate interactions between judges and case parties, and reviewing hearing decisions that agencies modify or reject. However, the Office should enhance these controls by revising its ethical code and policies and procedures, increasing its analysis of agency responses to hearing decisions, and revising its hearing evaluation form. Additionally, as statute requires, the Office should develop and implement a training program for agencies and office judges to further ensure it provides fair and independent hearings. Finally, although the Office generally meets timeliness requirements and standards for conducting hearings, it should take additional actions to better comply with these requirements."

Report, p. 5

**Response:**

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

**Finding 1 Recommendations**

"1.1 To further enhance its policies and procedures for ensuring that it provides fair and independent hearings, the Office should:

- a. Develop and implement written policies and procedures for:
  - o Periodically analyzing agencies' responses to hearing decisions to identify trends in judge error or bias that might warrant further review and/or action;
  - o Providing additional guidance on judges' ethical behavior to include conflicts of interest, participation in outside activities, and other activities the NAALJ model code of ethics covers that are relevant to the Office's judges; and
  - o All informal procedures it has established, such as informing hearing participants that they have the right to appeal a decision."

Report, p. 12

**Response:**

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

“b. Add evaluation questions relating to decision fairness, clarity, and timeliness; review the timing of when it solicits evaluation feedback; and consider developing an electronic evaluation that either supplements or replaces the paper evaluation.”

Report, p. 13

**Response:**

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

“1.2 To comply with A.R.S. §41 -1092.01, the Office should develop and implement formal training programs for agencies and its judges. These training programs should:

- a. Include topics related to ensuring fair and independent hearings;
- b. Include policies for judge training that specify minimum training requirements, guidelines for appropriate training received from outside sources, and procedures for ensuring that judges receive the required training; and
- c. Identify potential training topics for judges based on information obtained through some of its oversight and feedback procedures, such as supervisory review of judges, external feedback on the Office’s performance, and review of agency responses to judges’ decisions.”

Report, p. 13

**Response:**

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

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

Report, p. 13

**Response:**

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

## **Finding 2**

“The Office of Administrative Hearings (Office) should revise its rate-setting method to be consistent with best practices. The Office uses a cumbersome rate-setting method that results in agencies paying inequitable charges and other problems, such as jeopardizing another agency’s compliance with federal regulations and a lack of transparency. In addition, since fiscal year 2010, the Office has increased the charges to some agencies to cover shortfalls in its State General Fund appropriation and the amount it bills to the Arizona Department of Fire, Building and Life Safety. To address these issues, the Office should align its rate-setting method with best practices by developing and implementing a cost-based rate-setting method, developing and implementing written rate-setting policies and procedures, and taking steps to address any continued short fall between its State General Fund appropriation and the cost of services it provides to agencies the State General Fund supports.”

Report, p. 15

### ***Response:***

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

## **Finding 2 Recommendations**

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

- a. Examine the appropriate allocation of direct and indirect costs to its rates;
- b. Develop rates using average costs;
- c. Set its rates high enough to generate sufficient revenues during periods of high demand to build up enough cash reserves to cover its expenditures during periods of low demand; and
- d. Continue seeking to reduce costs as much as possible.”

Report, p. 25

### ***Response:***

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

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

Report, p. 25

**Response:**

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

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

- a. Develop and implement written policies and procedures to periodically review the funding status of agencies. The Office should design its policies and procedures to allow it to identify any agencies it has been treating as State General Fund-supported agencies that may no longer receive State General Fund support and to negotiate interagency service agreements with them if it determines it has the authority to do so;
- b. Once it has implemented a cost-based rate-setting method and can more accurately quantify the cost of services it provides to agencies the State General Fund supports, work with the Legislature to clarify how the Office should make up any continued shortfall between its State General Fund appropriation and the cost of services it provides to agencies the State General Fund supports; and
- c. Work with the Arizona Department of Fire, Building and Life Safety to ensure that its fee for condominium and planned community association hearings is sufficient to cover the cost of services the Office bills, or work with the Legislature to change the way the fee for these hearings is determined.”

Report, p. 25

**Response:**

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

## Sunset Factors Recommendations

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

\* \* \*

**• Office should improve its cash-handling, disbursement, and procurement practices—**The Office should continue developing and implementing policies and procedures to address longstanding control weaknesses for cash handling and disbursements...”

Report, p. 28

***Response:***

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

“...In order to reduce the risk of fraud and theft and ensure management’s intentions for spending public monies are met, the Office should continue implementing its new and revised policies and procedures and develop and implement policies and procedures to guide its procurement activities to help ensure these activities comply with procurement laws and regulations.”

Report, p. 30

***Response:***

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

Sincerely,

Cliff J. Vanell  
Director

## Performance Audit Division reports issued within the last 24 months

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|                 |   |
|-----------------|---|
| <b>12-04</b>    | Arizona State Parks Board   |
| <b>12-05</b>    | Arizona State Schools for the Deaf and the Blind  |
| <b>12-06</b>    | Arizona Health Care Cost Containment System—Medicaid Fraud and Abuse Prevention, Detection, Investigation, and Recovery Processes |
| <b>12-07</b>    | Arizona Health Care Cost Containment System—Sunset Factors  |
| <b>13-01</b>    | Department of Environmental Quality—Compliance Management   |
| <b>13-02</b>    | Arizona Board of Appraisal  |
| <b>13-03</b>    | Arizona State Board of Physical Therapy   |
| <b>13-04</b>    | Registrar of Contractors  |
| <b>13-05</b>    | Arizona Department of Financial Institutions  |
| <b>13-06</b>    | Department of Environmental Quality—Underground Storage Tanks Financial Responsibility  |
| <b>13-07</b>    | Arizona State Board of Pharmacy   |
| <b>13-08</b>    | Water Infrastructure Finance Authority  |
| <b>13-09</b>    | Arizona State Board of Cosmetology  |
| <b>13-10</b>    | Department of Environmental Quality—Sunset Factors  |
| <b>13-11</b>    | Arizona State Board of Funeral Directors and Embalmers  |
| <b>13-12</b>    | Arizona State Board for Charter Schools   |
| <b>13-13</b>    | Arizona Historical Society  |
| <b>CPS-1301</b> | Arizona Department of Economic Security—Children Support Services—Foster-Home Recruitment-Related Services Contracts              |
| <b>13-14</b>    | Review of Selected State Practices for Information Technology Procurement   |
| <b>13-15</b>    | Arizona Game and Fish Commission, Department, and Director  |
| <b>14-101</b>   | Arizona Department of Economic Security—Children Support Services—Transportation Services   |
| <b>14-102</b>   | Gila County Transportation Excise Tax   |
| <b>14-103</b>   | Arizona State Board of Dental Examiners   |

## Future Performance Audit Division report

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Arizona Board of Executive Clemency

State of Arizona Naturopathic Physicians Medical Board