

A REPORT  
TO THE  
**ARIZONA LEGISLATURE**

Performance Audit Division

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Performance Audit

# **Department of Economic Security—**

## Welfare Programs

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APRIL • 2004  
REPORT NO. 04 – 02



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**Debra K. Davenport**  
Auditor General

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

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AUDITOR GENERAL

**STATE OF ARIZONA**  
**OFFICE OF THE**  
**AUDITOR GENERAL**

WILLIAM THOMSON  
DEPUTY AUDITOR GENERAL

April 19, 2004

Members of the Arizona Legislature

The Honorable Janet Napolitano, Governor

Mr. David A. Berns, Director  
Department of Economic Security

Transmitted herewith is a report of the Auditor General, a Performance Audit and Sunset Review of the Department of Economic Security's welfare programs. This report is in response to a November 20, 2002, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the Sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting with this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Department of Economic Security 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.

This report will be released to the public on April 20, 2004.

Sincerely,

Debbie Davenport  
Auditor General

Enclosure

# PROGRAM FACT SHEET

## Arizona Department of Economic Security

### Division of Employment and Rehabilitation Services

#### Services:

The Department of Economic Security (Department) provides a variety of assistance programs to needy families and individuals throughout Arizona. The Division of Employment and Rehabilitation Services (DERS) is one of two divisions that administer the Department's primary welfare and employment programs.

DERS administers the State's Unemployment Insurance, Job Service (recruitment), and Vocational Rehabilitation Programs. Additionally, it provides job-training opportunities through the Workforce Investment Act and Jobs Program and administers a comprehensive set of child care programs through the Child Care Administration. Beginning in July 2004, the Division is required to privatize the Jobs Program and will then monitor the private contractors that will provide Jobs Program services.

#### Facilities and equipment:

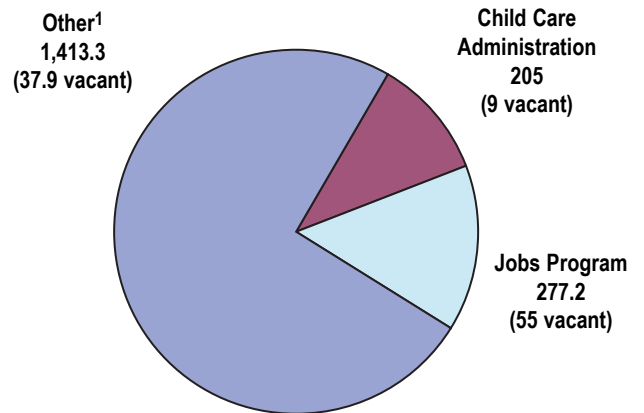
DERS leases office space in 102 locations, including 60 locations shared with other DES divisions, at an annual cost of nearly \$5.3 million. It also has offices in 19 DES-owned buildings. Additionally, DERS owns a variety of equipment and property, including standard office equipment such as computer equipment, furniture, and a \$3.2 million telephone system, and 94 vehicles, costing approximately \$1.75 million. DERS also owns other equipment, including scanners, Braille and eye-testing equipment, and Palm Pilots.

#### Mission:

To assist Arizonans in finding and maintaining meaningful work and independence and to develop a skilled, productive, and resilient workforce.

#### DERS staffing:

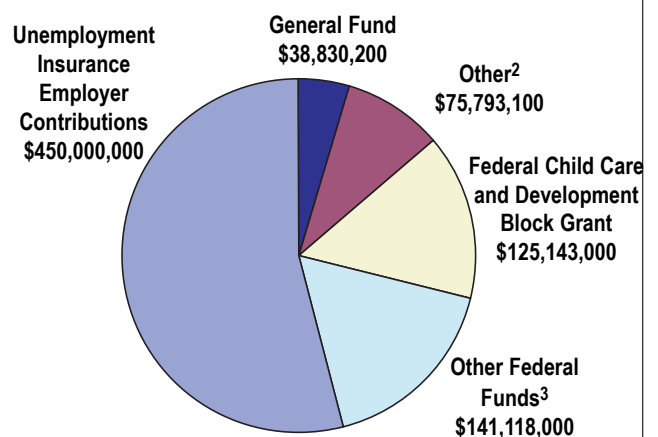
**1,895.5 FTE, as of June 30, 2003, including 101.9 vacancies**



<sup>1</sup> According to the Department, DERS' vacancies were unusually high due to Special Session budget reductions in fiscal year 2003.

#### DERS revenue:

**\$830,884,300 (fiscal year 2004 estimated)**



<sup>1</sup> Other Administrations within DERS include Employment Services, Rehabilitation Services, Workforce Development, and General Administration.

<sup>2</sup> Other revenues include employer taxes for job training, interest and penalties for late payments, and miscellaneous revenues.

<sup>3</sup> Other federal funds include TANF Block Grant, Workforce Investment Act Grant, Vocational Rehabilitation Grant, and Unemployment Insurance Grant.

## Jobs Program goals:

This audit focused on the Jobs Program in DERS. The Jobs Program has established the following goals:

- To increase the number of Temporary Assistance for Needy Families (TANF) participants who obtain employment.
- To increase the number of TANF participants placed in employment.
- To increase the number of TANF participants who obtain employment with medical benefits.
- To increase the number of participants who remain employed 90 days following placement.
- To increase the average wage of participants who obtain employment.

## Adequacy of goals and performance measures:

The Jobs Program's goals appear appropriate for its mission. However, it has established only one performance measure for each of its five goals. Further, although it has output and outcome measures, it does not have any input, efficiency, or quality measures. DERS should consider adding input measures, such as the number of TANF recipients participating in Jobs Program activities; efficiency measures, such as the average number of days to place a participant in a job; and quality measures, such as employer satisfaction with participants placed in jobs.

Source: Auditor General staff compilation of unaudited information obtained from the Department's Web site, the Department's FTE Status/Tracking Report for the year ended June 30, 2003, the Department's Datawarehouse, the Department's strategic plan, and information provided by the Department from its Financial Management Control System for the years ended June 30, 2002 and 2003, and other information provided by the Department.

# PROGRAM FACT SHEET

## Arizona Department of Economic Security

### Division of Benefits and Medical Eligibility

#### Services:

The Department of Economic Security (Department) provides a variety of assistance programs to needy families and individuals throughout Arizona. The Division of Benefits and Medical Eligibility (DBME) is one of two divisions that administer the Department's primary welfare programs.

DBME's Family Assistance Administration (FAA) administers the Temporary Assistance for Needy Families (TANF), food stamps, and state-funded General Assistance programs. Additionally, DBME determines eligibility for the State's medical assistance program (AHCCCS), as well as supplemental security income through its Disability Determination Services Administration.

#### Facilities and equipment:

DBME leases office space in 93 locations, including 60 locations shared with other DES divisions, at an annual cost of \$8.7 million. It also has offices in 11 DES-owned buildings. Additionally, DBME owns a variety of equipment and property, including standard office equipment such as computer equipment, furniture, and an approximately \$3 million telephone system, and 62 vehicles costing approximately \$1.15 million.

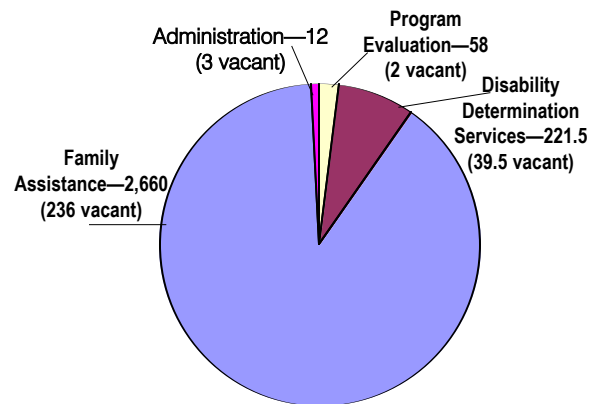
#### Mission:

Although DBME does not have its own mission, FAA's mission is:

To assist individuals and families to improve their quality of life.

#### DBME staffing:

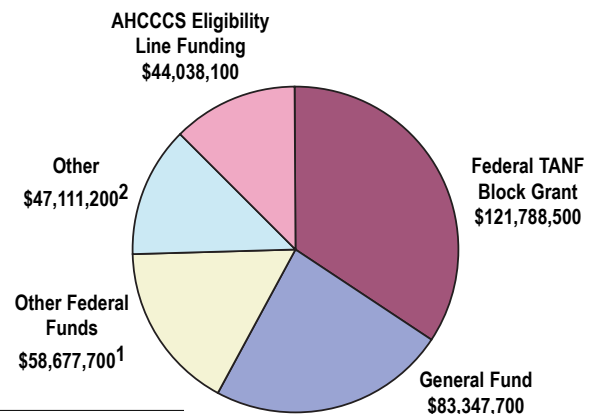
**2,951.5 FTE, as of June 30, 2003, including 280.5 vacancies<sup>1</sup>**



<sup>1</sup> According to the Department, DBME's vacancies were unusually high due to Special Session budget reductions in fiscal year 2003.

#### DBME revenue:

**\$354,963,200 (fiscal year 2004 estimated)**



<sup>1</sup> Other Federal Funds include Food Stamps Administration and Disability Determination Services Administration. They do not include \$616.4 million in Electronic Benefit Transactions for food stamps paid directly to a third-party contractor.

<sup>2</sup> Other revenues include tobacco taxes, general administrative activities, county share of eligibility determination costs, and miscellaneous.

## FAA Program Goals:

DBME does not have a mission and goals specific to it. Its FAA has established the following goals:

- To improve customer service and accessibility.
- To improve job satisfaction.
- To increase efficiency and accountability.

## Adequacy of goals and performance measures:

FAA's goals and objectives appear appropriate for its mission. FAA has performance measures that include all the recommended types of measures. Several of its efficiency and accountability objectives, such as maintaining a high accuracy rate in the Food Stamp Program, are measured using data collected under a formal quality control system to meet federal requirements.

DBME's Office of Strategic Planning, Budget, and Management Information compiles a monthly report on certain performance measures at the state-wide and district levels. According to the Office's manager, these reports are sent out of the districts. Providing such feedback is an important component of a good performance measurement system.

Source: Auditor General staff compilation of unaudited information obtained from the Department's Web site, the Department's FTE Status/Tracking Report for the year ended June 30, 2003, the Department's Datawarehouse, the Department's strategic plan, and information provided by the Department from its Financial Management Control System for the years ended June 30, 2002 and 2003, and other information provided by the Department.

# SUMMARY

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The Office of the Auditor General has conducted a performance audit of the Arizona Department of Economic Security's welfare programs, pursuant to a November 20, 2002, resolution of the Joint Legislative Audit Committee. This is the first in a series of audits of the Department of Economic Security (Department) and was conducted as part of the Sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq.

Arizona implemented federal welfare reform in 1996 through its Employing and Moving People Off Welfare and Encouraging Responsibility (EMPOWER) Redesign legislation. Before welfare reform, the federal Aid to Families with Dependent Children (AFDC) program provided cash assistance and other benefits to eligible families, but did not offer help or other incentives for participants to become employed. Arizona obtained an AFDC waiver in 1995 through the original EMPOWER legislation, which made several changes designed to reform welfare in the State. For example, it set time limits for participation, capped family size for benefits, allowed families to save money to ease the transition to working, and extended the length of time families who began working could continue to receive some benefits.

In 1996, federal welfare reform changed AFDC to Temporary Assistance to Needy Families (TANF), a block grant program that gives states more flexibility in program administration, requires nearly all cash assistance recipients to participate in work activities, and establishes a 5-year lifetime limit for receiving benefits. Although Arizona had already modified its welfare program under the 1995 AFDC waiver, the State made further modifications to conform with the federal lifetime limit. The Legislature modified state law in 2003, effective September 2002, to conform to federal requirements. According to the Department, it implemented the lifetime limit in October 2002, after its waiver expired. Arizona uses block grant funding, in combination with state monies, to pay for three of its four largest welfare programs: TANF, the Jobs Program, and Child Care Assistance. The fourth program, Food Stamps, receives nearly all of its funding from the U.S. Department of Agriculture.

- **Temporary Assistance for Needy Families (TANF)**—TANF provides cash assistance to eligible families. A total of 50,280 households received assistance from this program during June 2003.



- **Food Stamps**—The Department issues food stamp benefits to low-income families and other eligible households. A total of 190,954 households received assistance from this program during June 2003.
- **Jobs Program**—Nearly all adult TANF recipients must participate in work activities through the Jobs Program, which provides training and other services intended to help families make the transition from welfare dependence to employment. A total of 14,614 individuals were actively participating in the Jobs Program during June 2003.
- **Child Care Assistance**—The Department pays all or part of day care costs for some Jobs Program participants, other low-income families, and families referred by Child Protective Services to enable them to work or participate in training. A total of 46,522 children were authorized to receive day care through this program in June 2003.

## Department should ensure proper oversight of privatized Jobs Program (see pages 13 through 21)

State law requires the Department to privatize the Jobs Program by July 2004. The program provides job training and other services to help TANF cash assistance recipients move off welfare by obtaining employment. As long as participants comply with program requirements, such as searching for a job or obtaining training, they can receive other assistance such as transportation assistance, clothing vouchers, and tools and equipment needed for a job. With few exceptions, all TANF recipients are required to participate in the Jobs Program in order to continue receiving cash assistance. Currently, the Department provides case management for Jobs Program participants with its own staff in most parts of the State.

To successfully meet its requirement to privatize the State's Jobs Program, the Department needs to ensure that it can effectively oversee the work the contractors will perform. A portion of the Jobs Program is run by a private contractor under a program called Arizona Works, but by statute, the Department must change the entire Jobs Program to a contractor-operated function by July 1, 2004. Currently, during the 2004 legislative session, the Legislature is considering a bill to extend that deadline to July 1, 2005, or July 1, 2006. Effective administration of the Jobs Program, whether under state or contract employees, is important because it affects the amount of money the State receives from the federal government. If the program is particularly well-run, the State will receive bonuses; if it is deficient, the State could be penalized.

Auditors identified two main areas in which the Department needs to strengthen its preparations for privatizing the Jobs Program. First, the Department needs to more

thoroughly prepare for monitoring the contractors. Prior to January 2003, the Department did only limited monitoring of the Arizona Works contractor. Once the Department increased its monitoring, it found that the contractor was not complying with court-ordered requirements, had high error rates, and was not correctly reporting program data. Auditors' review of the Department's initial request for proposals from potential contractors for the state-wide privatized Jobs Program showed that the specifications were deficient in such matters as ways for measuring performance. The Department has since withdrawn the request for proposals and has yet to release a new one. The Department needs to step up its efforts to train its own monitoring staff, train contractors in procedures for complying with federal requirements, and develop specific monitoring plans. Second, the Department needs effective internal controls to secure its data. In addition, the Department needs to develop additional security and training requirements for its contractors to protect sensitive data.

## Department can more effectively manage its food stamp eligibility determination process (see pages 23 through 27)

The Department's Division of Benefits and Medical Eligibility (Division), while successful in the past in lowering its food stamp eligibility determination error rate, needs to take steps to counter expected increases in this rate. The Division successfully reduced its food stamp error rate from 15.42 percent in 1994 to 5.27 percent in 2002, and received several bonuses from the federal government for keeping the error rate below federal thresholds. However, according to division management, the error rate for federal fiscal year 2003, which is required to be certified by June 2004, is expected to rise because of increasing total caseloads coupled with reductions in eligibility determination staff, which resulted in higher caseloads for eligibility interviewers.

Using a focus group of local office managers within the Division, auditors identified several areas in which the Division can more effectively manage its eligibility determination process. The Division's local office managers identified barriers to accurate eligibility determinations, including frequent policy changes and clarifications, the absence of a local office manager's training program, and supervisors' failure to meet quotas for case file reviews. To address these issues, division management should ensure that local office supervisors consistently review case files to help ensure that eligibility determination errors are identified and corrected, continue its efforts to improve its policy change notification process, and establish a management training program for local office managers.

## Department should improve management of its benefit overpayment referrals process (see pages 29 through 33)

The Division should establish a more reliable and effective system for managing its benefit overpayment referral process. As of December 2003, internal reports compiled by the Division indicated that its offices had accumulated a backlog of more than 7,700 TANF and food stamp overpayment referrals that had not yet been assessed and confirmed as claims. Based on an analysis of the Division's internal reports, auditors estimate that the more than 7,700 referrals could potentially represent approximately \$2 million in overpayments. During the past year, the Division increased the number of overpayment specialists from 19 to 44 to help process overpayment referrals. As a result, the Division was able to reduce its pending overpayment referrals from more than 13,000 in July 2003 to its December 2003 level of 7,700. After audit work was conducted, the Division reported that it further reduced its pending overpayment referrals to approximately 1,800, as of February 2004.

It is important that the Division process its backlog of overpayment referrals in a timely manner to increase the likelihood that the monies will be repaid and because the federal government allows states to keep a portion of their overpayment collections. In fiscal year 2003, the collections office collected nearly \$2.7 million in food stamp overpayments and slightly more than \$1.7 million in TANF overpayments. The food stamp collections were consistent with collection rates for past fiscal years and met federal food stamp overpayment collection standards. The State retains TANF overpayment collections and uses them for program costs. In federal fiscal year 2003, the federal government allowed the State to retain more than \$420,000 of its food stamp overpayment collections. The federal government does not restrict the states' use of retained food stamp collections.

The Division should also improve its process for managing overpayment referrals. During fiscal year 2003, the Division's internal reports indicate that over 50 percent of overpayment referrals were not pursued as claims. Some overpayment units reported dropping a substantial portion of these overpayment referrals because the necessary case files could not be located. Therefore, to help the Department collect more overpayments, the Division should continue its efforts to implement an electronic document-scanning system to limit the number of overpayment referrals that are dropped because of inaccessible case files.

## Other pertinent information (see pages 35 through 41)

**Welfare reform impact**—Auditors developed information about the requirements and effects of welfare reform in Arizona and nationally. Welfare reform's primary purpose was to end dependence on government benefits by promoting job preparation, work, and marriage. The 1996 Personal Responsibility and Work Opportunity Reconciliation Act changed welfare funding to a block grant that gives states more flexibility in implementing welfare programs, and established new requirements such as work participation and a lifetime limit for receiving benefits. The Department operates the State's welfare programs under a program called EMPOWER Redesign. EMPOWER has a work-first orientation that requires nearly all TANF cash assistance recipients to participate in work activities in order to receive benefits. It also established Arizona's cash benefit amount, and caps benefit levels according to the family's size when it begins receiving benefits. The Jobs Program, which provides training and other services to help participants obtain work, and the Child Care Assistance Program, which pays all or part of day care costs to enable participants to work or attend training, are integral parts of Arizona's welfare program under EMPOWER. As of March 2002, Arizona's TANF cash assistance recipients received a monthly average of \$272.23 per family (33rd nationally), compared to the national average of \$412.40. Arizona's amount is based on raising eligible families' income to 36 percent of the 1992 Federal Poverty Level.

Between 1996, when the new program began, and March 2002, average caseloads nationally dropped by 53.8 percent, and Arizona's welfare caseload fell by 39.2 percent. With the drop in caseloads, Arizona accumulated some reserves from the federal funding provided to operate the program, and it has been able to use these reserves to supplement its budget in subsequent years.

According to federal studies, welfare reform has had a positive impact on family income. For example, average monthly earnings for employed welfare recipients rose 49 percent from federal fiscal years 1996 to 2001. However, moving from welfare to work does not guarantee that single mothers will be able to lift their families out of poverty. Auditors were unable to obtain data to show the impact on income for Arizona recipients.

**Employee fraud**—Auditors also gathered information about recent welfare-related employee fraud cases in the Department. During fiscal year 2003, the Department investigated and substantiated 13 welfare-related employee fraud cases. The cases involved at least 15 division employees who allegedly circumvented internal controls and fraudulently obtained TANF and food stamp benefits for themselves and their accomplices. Although the value of several cases will not be determined until prosecution is complete, the Department estimates that the values of some cases ranges from \$586 to \$57,010. The Attorney General's Office is preparing several of these cases for criminal prosecution. The Division has developed a corrective action plan that includes improving the Division's Electronic Benefit Transfer policies and

procedures, increasing security controls, and creating system-generated reports to monitor for unusual benefit issuance activity at the local offices. The Office of the Auditor General is examining the adequacy of the Division's newly implemented procedures for monitoring, identifying, and preventing employee welfare fraud, and will report its finding in March 2004.

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concluded ♦

# INTRODUCTION & BACKGROUND

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The Office of the Auditor General has conducted a performance audit of the Arizona Department of Economic Security's welfare programs, pursuant to a November 20, 2002, resolution of the Joint Legislative Audit Committee. This is the first in a series of audits of the Department of Economic Security (Department) and was conducted as part of the Sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq.

## History of welfare

Welfare in the United States changed substantially in 1996. Before 1996, the nation's primary welfare program was Aid to Families with Dependent Children (AFDC). This program provided cash assistance to needy families based on states' eligibility criteria that was set within federal limitations. States defined "need," set their own benefit levels, established (within federal limitations) income and resource limitations, and administered the program or supervised its administration. A rapid growth in welfare caseloads, concerns about program costs, and concerns about beneficiaries' long-term dependence on welfare assistance prompted the federal government to review national welfare policy. As a result, in the 1990s the federal government increasingly used its authority to grant waivers authorizing states to modify the way they implemented AFDC.

By 1996, a total of 43 states, including Arizona, had waivers that required AFDC recipients to work, limited the time families could receive assistance, improved child support enforcement, and encouraged parental responsibility. Arizona's waiver program, called EMPOWER (Employing and Moving People Off Welfare and Encouraging Responsibility), was established through legislation in 1994, and Arizona received federal approval to implement it effective November 1995. Among other provisions, EMPOWER limited how long a person could receive assistance, capped family size for benefits, extended child care and medical assistance, established sanctions for failure to meet work requirements, and allowed families to establish savings accounts for education and training purposes.



In 1996, the federal Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA), commonly called welfare reform, replaced AFDC nation-wide with Temporary Assistance for Needy Families (TANF). The new program provides funding through a block grant that gives states more flexibility to determine who is to be served and what services to provide. In addition, TANF requires nearly all recipients to participate in work activities and establishes a uniform national 5-year lifetime limit for receiving benefits.<sup>1</sup> (See Other Pertinent Information, pages 35 through 41, for information on the impact of welfare reform.)

## Welfare in Arizona

The Department provides a variety of assistance programs to eligible families and individuals throughout Arizona. In addition to administering several federal and state welfare programs, the Department coordinates with local community food banks, employment agencies, and charitable organizations to create a network of services for Arizona's needy populations.

The Department's four largest welfare-related programs are all federally mandated:

- **Temporary Assistance for Needy Families (TANF)**—In 1996, TANF replaced the previous welfare program, Aid to Families with Dependent Children. TANF provides temporary cash assistance to children and their families. Eligible persons include dependent children under age 18, and parents or certain other relatives of eligible children who meet certain income and asset thresholds (see Table 1, page 3). State and federal law limits TANF participation to 5 years except in hardship cases, such as the fact that the family includes someone who has been subject to physical, sexual, or mental abuse; threats of physical or sexual abuse; or deprivation of medical care. The state may expand this federal hardship definition as long as no more than 20 percent of the families receiving assistance exceed the 5-year limit. In June 2003, the Department reported a TANF cash assistance caseload of 50,280 households, a 17 percent increase over the previous year. The Department must comply with federal TANF work participation requirements (see Finding 1, pages 13 through 21). However, because TANF is a block grant program, the federal government allows states flexibility in how they use the money for their welfare programs.<sup>2</sup> For example, unlike AFDC, TANF allows states to use TANF funds in a way that helps to end needy parents'

### Facts about TANF households in Arizona

- Most are families of two or three people
- Two-person families can receive up to \$275 per month cash assistance and \$256 in food stamps
- Three-person families can receive up to \$347 per month cash assistance and \$366 in food stamps
- About one-fourth of all families and half of two-parent families participate in the Jobs Program
- Average time on cash assistance is less than 8 months
- Department officials report 22 percent use child care assistance

Source: Department of Economic Security Welfare Reform Report for Fiscal Year 2003 and other information provided by department administrators.

<sup>1</sup> States can choose to extend assistance beyond the limit for up to 20 percent of families because of circumstances, such as hardship, defined by the state.

• <sup>2</sup> States must design their own plans for promoting work over welfare and self-sufficiency over dependency. These plans are subject to U.S. Department of Health and Human Services approval and must meet federal requirements such as ensuring that at least half of TANF families are engaged in work activities and limiting adult assistance to 5 years.

**Table 1:** Eligibility Requirements for Four Welfare Programs  
As of January 2004

- Temporary Assistance for Needy Families (TANF)**
- Dependent child under 18, or parent or specified relative of eligible child, or woman in her last trimester of pregnancy, and
  - Monthly family income below limits based on 1992 federal poverty level, and
  - Family assets below \$2,000, excluding a primary vehicle and homestead property, and
  - Participate in Jobs Program unless exempt or deferred, and
  - Has not exceeded time limits for receiving benefits except in cases of hardship.

TANF Income Limits	TANF Exemptions/Deferral
<ul style="list-style-type: none"> <li>• Gross income below 185% of 1992 level, and</li> <li>• Adjusted gross income below 36% of 1992 level.</li> </ul> <p><b>Adjustments:</b> \$90 for work-related expenses, 30% of the remaining gross income, some child care costs (\$200 for a child over 2), dependent's income.</p>	<p>Applicant is 16 to 18 years old and a full-time student, is a dependent child under age 13, is already employed, or is a parent with a baby up to 1 year old.</p>

**Example:** 1992 federal poverty level for a family of three is \$11,570 per year, or \$964 per month. To be eligible for TANF, the family must have a gross income below \$1,784 and an adjusted gross monthly income below \$347.

- Food Stamps**
- Monthly family income below limits based on the current federal poverty level, and
  - Family assets below limits

Food Stamps Income Limits	Food Stamps Asset Limits
<ul style="list-style-type: none"> <li>• Gross income below 130% of current level, and</li> <li>• Adjusted income below current level</li> </ul> <p><b>Adjustments:</b> 20% of earned income, standard deduction of \$134, and other deductions such as for some child care, excess shelter costs, and medical expenses.</p>	<ul style="list-style-type: none"> <li>• \$3,000 for a household of two or more people with a least one member over age 60, or</li> <li>• \$2,000 for all other families.</li> </ul> <p><b>Exclusions:</b> primary residence, household goods, vehicles used for income-producing or other defined purposes, and some other assets such as some income-producing property and some property essential to employment.</p>

- Jobs Program**
- TANF recipient, or
  - Former TANF recipient can receive some services for up to 2 years after ending TANF benefits.

- Child Care Assistance**
- TANF recipient employed full- or part-time, or
  - TANF recipient needing child care in order to participate in Jobs Program, or
  - Former TANF recipient can receive services for up to 2 years, or
  - Family referred by Child Protective Services, or
  - Family with income at or below 165% of federal poverty level

<sup>1</sup> All programs require recipients to be Arizona residents, and U.S. citizens or eligible noncitizens.

Source: Auditor General staff compilation of information from Arizona Revised Statutes, the Arizona Administrative Code (R6-12-304 through 503 and 6-14-201 through 310), the Arizona TANF State Plan, the Arizona Child Care and Development Fund State Plan (FFY 2003-2005), the U.S. Code of Federal Regulations (7 CFR Chapter II Part 273), the Arizona Department of Economic Security Division of Employment and Rehabilitation Services Jobs Program Policy Manual (April 1, 2003), the U.S. Department of Agriculture Web site (*Applicants & Recipients: Fact Sheet on Resources, Income, and Benefits*, downloaded October 8, 2003), and the U.S. Department of Health and Human Services Web site (prior HHS Poverty Guidelines, downloaded January 28, 2004).

dependence on government benefits or allows children to be cared for at home. Arizona has set its monthly benefit rate somewhat lower than the national average, and follows a work-first philosophy that requires recipients to participate in the Jobs Program as soon as possible. Compared to Arizona's \$347 benefit for a family of three in 2001, other states' benefits ranged from \$164 in Alabama to \$923 in Alaska in 2001, according to the U.S. Department of Health and Human Services' most recent annual report to Congress.<sup>1</sup> Also, in contrast to Arizona, some states allow a 2-month to 30-month delay before they require TANF recipients to participate in the Jobs Program.

- **Food Stamps**—Food stamps are provided to low-income families and other households, whether or not there are children in the household.

Food stamp recipients must also meet certain federally established income and asset thresholds (see Table 1, page 3). These thresholds differ from that of TANF; thus, a family may receive food stamps but not qualify for TANF. Participants use food stamp benefits like cash to purchase eligible food and other approved products. Individual benefits are based on the U.S. Department of Agriculture's Thrifty Food Plan, an estimate of what it costs to provide nutritious yet inexpensive meals. In June 2003, the Department reported that its food stamp caseload was 190,954 households, including 491,250 persons, a 26 percent increase in food stamp households over the previous year.

- **Jobs Program**—The Jobs Program provides services to help individuals make the transition from welfare dependence to employment. For example, it provides career preparation courses, GED testing fees, and vocational training. In addition, as

long as the participant complies with program requirements, such as engaging in prescribed training or work search activities, the Jobs Program provides a variety of other support services including transportation assistance, clothing vouchers, testing and licensing, tools and equipment needed for a job, and relocation and housing assistance. Additionally, the Jobs Program provides limited medical, vision, dental, and mental health co-payments not provided through other programs, such as the Arizona Health Care Cost Containment System (AHCCCS). Finally, the Jobs Program provides day care registration fees and co-payments not provided through other programs, such as the Child Care Assistance program.

All TANF participants are required to participate in the Jobs Program as soon as Jobs Program staff can activate their case, unless the Department grants a temporary deferral or they have a job but still qualify for TANF. For example, a parent may request delayed participation until the baby is 1 year old. In addition,

### Facts about Food Stamps households in Arizona

- About one-fourth receive TANF cash assistance
- The most common household size is three people
- Average food stamp benefit is \$228 per month
- Individuals with monthly net income below \$739 can receive up to \$139 per month in Food Stamps
- About 14 percent of recipients are in one-person households, 16 percent are in two-person, and 20 percent in three-person households.

Source: Department of Economic Security Welfare Reform Report for fiscal year 2003 and other information provided by department administrators.

• 1 U.S. Department of Health and Human Services, Administration for Children and Families, Office of Family Assistance. *Temporary Assistance for Needy Families Program (TANF) Fifth Annual Report to Congress*. February 2003.

former TANF recipients can receive Jobs Program assistance for up to 2 years following closure of their TANF case. As of June 30, 2003, the Department reported having 14,614 active Jobs Program participants, an increase of 37 percent over the previous year. Further, it reported that, due to increasing caseloads, it had not activated an additional approximately 11,700 referrals.

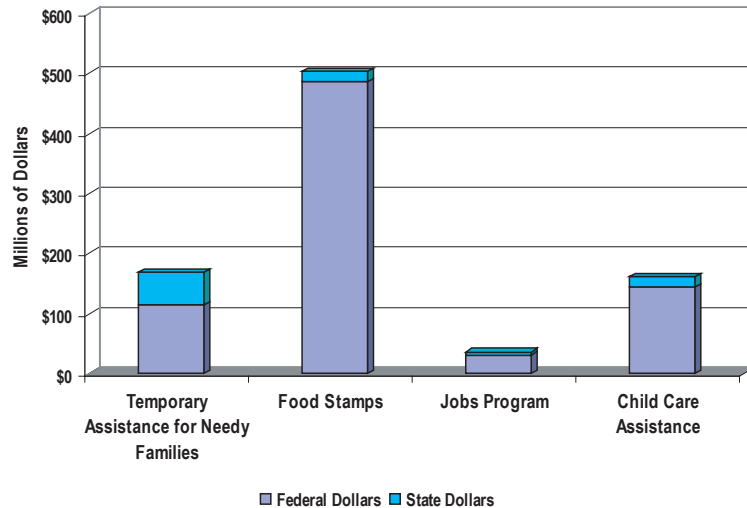
- **Child Care Assistance**—This program assists eligible families with day care costs, enabling parents to participate in employment and specific training activities related to employment. Four groups are eligible to receive child care assistance: current TANF recipients who need child care for work or to participate in the Jobs Program, former TANF recipients for up to 2 years who need child care for the same reasons, all families referred by Child Protective Services, and other families with income up to 165 percent of the Federal Poverty Level (see Table 1, page 3). Participants may be required to pay co-payments, depending on their income, and children must be cared for by contracted providers. Child care payments average about \$289 per month per child. In June 2003, the Department reported that 46,522 children were authorized to receive child care assistance, a decrease of 3.6 percent from the previous year. The decrease occurred because the Department initiated a waiting list in March 2003 as a result of budget constraints. As of June 2003, the Department reported that there were 2,456 families (an estimated 4,838 children) on the waiting list, and in January 2004, the list had grown to 3,982 families (an estimated 7,964 children). All the children on the list are from families who qualify for assistance because their families earn less than 165 percent of the Federal Poverty Level. Current and recent TANF recipients who are eligible for child care assistance and those referred by Child Protective Services automatically receive child care assistance and are not put on the waiting list.

More than 5,000 children are on a waiting list for child care assistance.

In addition to these four main federally mandated programs, the Department determines AHCCCS medical eligibility and administers several other, smaller assistance programs. Those programs include general assistance, which provides interim cash assistance to disabled persons who have applied for federal Social Security Income benefits, a tuberculosis control program that helps persons who are unemployable because of communicable tuberculosis, and a federally funded refugee resettlement program. The Department also administers Arizona's unemployment insurance program. This employer-funded program pays benefits to workers who are unemployed through no fault of their own.

Most benefits are provided electronically. Under the federal welfare reform laws, in 1998, Arizona implemented an electronic benefits transfer (EBT) program. The federal government requires electronic benefits transfers for all food stamp programs. Under this program, welfare assistance clients access their benefits by using an EBT card, known as the Quest card. The Quest card is similar to a debit card and holds cash and food stamp benefits. The Department currently contracts with a private company, Citicorp, to administer the EBT program, including updating

**Figure 1:** Source of Funding by Welfare Program  
Year Ended June 30, 2003



Source: Auditor General staff analysis of the FY 2003 Budget Summary prepared by the Department of Economic Security, Division of Benefits and Medical Eligibility.

benefit information monthly. EBT program implementation costs, transaction fees, and equipment costs for point-of-sale devices are shared equally between the federal government and the State. According to the Department's cost-benefit analysis report to the federal government at the time of implementation, these costs are more than offset by savings in administrative expenses and reduction in food stamp losses. Further, issuing benefits by updating EBT cards was intended to provide better control over fraud by making it harder for recipients to sell food stamps for cash or for stores to accept food stamps for unallowed items.

## Budget

Funding for Arizona's welfare programs comes from a combination of federal and state sources. Much of the funding comes from the annual TANF block grant. The U.S. Department of Health and Human Services (DHHS) provides the block grant to all states based on historical spending levels for Aid to Families with Dependent Children (AFDC), Emergency Assistance, and Job Opportunities and Basic Skill

Eighty-nine percent of Arizona welfare programs' funds comes from federal sources.

Programs (JOBS), the precursors to TANF. Arizona's block grant totaled more than \$222 million in federal fiscal year 2003. The State allocates a significant portion of TANF block grant monies to three welfare programs: TANF, Jobs Program, and Child Care Assistance. Specifically:

- **TANF**—In fiscal year 2003, the Division of Benefits and Medical Eligibility (DBME) received more than \$113 million, or about two-thirds of its total TANF funding from the annual TANF block grant, as shown in Table 2 (see page 8). The Legislature appropriated more than \$51.4 million from the General Fund for the TANF program in fiscal year 2003.
- **Food Stamps**—In fiscal year 2003, DBME reported that the General Fund provided more than \$18 million to cover approximately one-half of DBME's administration costs for the Food Stamps Program. DBME provides clients with food stamp benefits through its Electronic Benefit Transfer System (EBT) Program, which is administered by a contractor that receives funding directly from the USDA. In fiscal year 2003, the USDA provided \$465.4 million in food stamp benefit reimbursements to DBME's EBT contractor, as shown in Table 2, footnote 4 (see page 8).
- **Jobs Program**—For fiscal year 2003, the Legislature approved over \$20.3 million in federal TANF monies for the Jobs Program administered by the Division of Employment and Rehabilitation Services (DERS). Additionally, the Joint Legislative Budget Committee (JLBC) reports that DERS received federal Workforce Investment Act funding of \$2 million, General Fund monies of nearly \$1.9 million, and \$1.5 million from the Special Administration Fund to help fund the Jobs Program.
- **Child Care Assistance**—Federal dollars provide nearly 90 percent of Arizona's Child Care Assistance funding. In fiscal year 2003, the Department received a little more than \$101.3 million from the Federal Child Care and Development Block Grant, as shown in Table 3 (see page 9). The Legislature appropriated \$38.9 million from TANF monies and almost \$19.3 million from the General Fund.

## Organization and staffing

This audit focused on welfare programs administered by two divisions within the Department, the Division of Benefits and Medical Eligibility and the Division of Employment and Rehabilitation Services. The Department operates administrative offices in Phoenix and six districts with local offices throughout the State.

**Table 2:** Division of Benefits and Medical Eligibility  
Schedule of Revenues and Expenditures<sup>1</sup>  
For the Years Ended or Ending June 30, 2002, 2003, and 2004  
(Unaudited)

	<b>2002 (Actual)</b>	<b>2003 (Actual)</b>	<b>2004 (Budgeted)</b>
<b>Revenues:</b>			
State General Fund appropriations <sup>2</sup>	\$ 86,613,078	\$ 81,590,200	\$ 83,347,700
General administrative activities <sup>3</sup>	11,984,500	11,928,416	11,181,500
Government grants and contracts:			
Federal Temporary Assistance for Needy Families	88,587,934	113,605,763	121,788,500
Food Stamps Administration <sup>4</sup>	24,057,108	27,565,492	26,777,700
Disability Determination Services Administration	19,535,963	20,961,205	31,900,000
AHCCCS Eligibility Line Funding <sup>5</sup>	40,228,841	35,284,053	44,038,100
Tobacco taxes <sup>6</sup>	44,840,508	34,505,700	26,570,000
County share of eligibility determination costs	450,000	8,418,200	5,200,000
Miscellaneous	170,864	301,503	4,159,700
<b>Total revenues</b>	<u>316,468,796</u>	<u>334,160,532</u>	<u>354,963,200</u>
<b>Expenditures: <sup>7</sup></b>			
Personal services and employee-related	100,237,583	107,830,717	108,097,600
Professional and outside services	12,611,639	11,684,074	8,322,000
Travel	2,168,498	938,468	690,900
Assistance to individuals and other governments	145,548,435	169,141,065	188,141,900
Equipment	5,778,946	607,804	361,500
Other	9,254,166	8,357,833	9,575,000
Support services costs	40,411,605	35,494,663	39,774,300
<b>Total expenditures</b>	<u>316,010,872</u>	<u>334,054,624</u>	<u>354,963,200</u>
<b>Excess of revenues over expenditures</b>	<u>\$ 457,924</u>	<u>\$ 105,908</u>	<u>\$ - 0</u>

<sup>1</sup> Amounts presented for 2002 and 2003 represent actual revenues and expenditures as of November 5, 2003; however, the Department anticipates further administrative adjustments for those years. In addition, amounts presented for 2004 represent budgeted revenues and expenditures.

<sup>2</sup> Amounts presented are net of unexpended appropriations that the Department anticipates will be reverted to the State General Fund. The Department estimates the reversion to be \$155,100 for 2002, but has no estimate for 2003.

<sup>3</sup> The Department allocates support service costs to its various divisions. That portion of the support service costs allocated to the Division that was funded by the Department's Administration Division budget is reported as general administrative activities revenues in this schedule.

<sup>4</sup> Amounts presented do not include Electronic Benefit Transactions (EBT) for the Food Stamps Program of approximately \$356.1 million and \$465.4 million for 2002 and 2003, respectively, and \$616.4 million estimated for 2004, as these transactions are processed by a third-party contractor who receives payment directly from the federal government.

<sup>5</sup> Consists of monthly premium payments from the Arizona Health Care Cost Containment System (AHCCCS) for providing healthcare services to eligible participants.

<sup>6</sup> Consists of tobacco tax settlement receipts allocated to the Department for eligibility determination costs for Title XIX program members.

<sup>7</sup> Amounts presented are net of amounts reimbursed by tribal governments for EBT payments made to tribal members. The Department received tribal reimbursements of approximately \$18.9 million and \$7.7 million for 2002 and 2003, respectively, and estimates receiving \$5.3 million for 2004.

Source: Auditor General staff analysis of financial information provided by the Arizona Department of Economic Security for the years ended June 30, 2002 and 2003, from its Financial Management Control System, and budgeted information provided by the Department for the year ending June 30, 2004, as of November 5, 2003.

**Table 3 :** Division of Employment and Rehabilitation Services  
Schedule of Revenues and Expenditures<sup>1</sup>  
For the Years Ended or Ending June 30, 2002, 2003, and 2004  
(Unaudited)

	2002 (Actual)	2003 (Actual)	2004 (Budgeted)
<b>Revenues:</b>			
State General Fund appropriations <sup>2</sup>	\$ 38,856,300	\$ 33,685,400	\$ 38,830,200
General administrative activities <sup>3</sup>	2,238,917	1,936,076	2,224,500
Government grants and contracts:			
Federal Child Care and Development	79,101,800	101,317,700	125,143,000
Federal Temporary Assistance for Needy Families	74,759,500	65,998,000	23,016,500
Federal Workforce Investment Act	47,591,900	47,527,500	58,960,700
Federal Vocational Rehabilitation	37,887,196	36,821,250	23,489,800
Federal Unemployment Insurance	34,652,916	35,472,637	35,651,000
AHCCCS capitation payments <sup>4</sup>	6,341,637	6,383,683	
Federal Reed Act	3,578,000		
Other	40,544,036	46,131,679	65,858,200
Employers' unemployment insurance contributions	403,686,120	301,956,465	450,000,000
Job Training Fund <sup>5</sup>			3,746,400
Special Administration Fund <sup>6</sup>	3,585,000	1,585,000	1,585,000
Spinal and Head Injury Trust Fund <sup>7</sup>	2,188,200	2,366,900	2,379,000
Total revenues	<u>775,011,522</u>	<u>681,182,290</u>	<u>830,884,300</u>
<b>Expenditures:</b>			
Personal services and employee-related	66,304,107	68,986,201	70,343,900
Professional and outside services	4,130,210	5,044,327	5,062,600
Travel	1,295,282	1,004,695	1,349,100
Assistance to individuals and other governments	677,181,875	585,756,891	717,921,500
Equipment	3,274,656	1,203,082	3,458,500
Other	7,862,311	7,308,462	8,437,500
Support services costs	<u>25,223,824</u>	<u>24,585,081</u>	<u>24,311,200</u>
Total expenditures	<u>785,272,265</u>	<u>693,888,739</u>	<u>830,884,300</u>
Deficiency of revenues under expenditures <sup>8</sup>	<u>\$(10,260,743)</u>	<u>\$(12,706,449)</u>	<u>\$ -0</u>

<sup>1</sup> Amounts presented for 2002 and 2003 represent actual revenues and expenditures as of October 31, 2003; however, the Department anticipates further administrative adjustments for those years. In addition, amounts presented for 2004 represent budgeted revenues and expenditures.

<sup>2</sup> Amounts presented are net of unexpended appropriations that the Department anticipates will be reverted to the State General Fund. The Department estimates these reversions to be \$2.5 million for 2002 and \$500,000 for 2003.

<sup>3</sup> The Department allocates support service costs to its various divisions. That portion of the support service costs allocated to the Division that was funded by the Department's Administration Division budget is reported as general administrative activities revenues in this schedule.

<sup>4</sup> Consists of payments from the Arizona Health Care Cost Containment System to provide long-term support services to persons with developmental disabilities who need additional assistance to maintain employment. In 2004, this program was moved to another division within the Department and, therefore, is not included in the 2004 budgeted amounts presented.

<sup>5</sup> Consists of taxes collected from employers for job training pursuant to A.R.S. §23-769.

<sup>6</sup> Consists of interest and penalties collected from employers who fail to make timely contributions to the unemployment insurance program.

<sup>7</sup> Consists of assessments on speeding violations pursuant to A.R.S. §12-116.02 and interest on investments.

<sup>8</sup> The deficiency of revenues under expenditures was paid for with the Department's available nonappropriated fund balance.

Source: Auditor General staff analysis of financial information provided by the Arizona Department of Economic Security for the years ended June 30, 2002 and 2003, from its Financial Management Control System, and budgeted information provided by the Department for the year ending June 30, 2004, as of October 31, 2003.



- **Division of Benefits and Medical Eligibility (DBME), 2,951.5 FTE**—DBME operates in 104 local offices. It serves as the intake center for the Department's welfare programs. DBME's Family Assistance Administration (FAA) determines eligibility for TANF and food stamps. In addition, under an agreement with AHCCCS, FAA determines eligibility for medical assistance. Altogether, the Department reports that these programs received approximately 933,000 applications during fiscal year 2003. FAA also provides information to clients regarding other avenues for assistance. It has 2,660 FTE who work in the Department's 104 local offices, 58 medical facilities, and 81 community organization sites. In addition to these FAA staff, DBME has 60 staff in its Office of Program Evaluation, responsible for quality control over TANF, food stamp, and general assistance eligibility determination, and 221.5 staff in the Disability Determination Services Administration, which is responsible for determining Supplemental Security Income and Social Security Disability Insurance eligibility. Additionally, DBME has 15 FTE in Administration.
- **Division of Employment and Rehabilitation Services (DERS), 1,895.5 FTE**—DERS administers programs that provide training and support to help people prepare for and find jobs. The Jobs Program is intended to help TANF and food stamp recipients to move off welfare and into self-sufficiency. Until July 1, 2004, the Department will administer the Jobs Program throughout the State except in eastern Maricopa County, where a privatized program, called the Arizona Works Program, provides job services. As of that date, the Department must privatize the Jobs Program state-wide in accordance with Laws 2003, Ch. 223. Then, the Department will be responsible for oversight of the private Jobs Program service providers and Jobs Program contract management, and will administer the program directly only in areas where it cannot find appropriate contractors. The Jobs Program has 277.2 FTE at 45 field offices and 8 temporary sites. The Child Care Administration in DERS helps eligible, low-income families pay child care expenses. Eligible clients include those referred from TANF, the Jobs Program, or Child Protective Services. The Child Care Administration has 205 FTE located at 41 field offices and 5 temporary sites. Additionally, DERS administers nonwelfare programs through its Employment Services, Rehabilitation Services, and Workforce Development Administrations, which have a total of 1,413.3 FTE.

## Scope and methodology

This audit focused on three of the Department's four main welfare programs, including preparations for privatization of the Jobs Program, TANF and food stamp eligibility determination processes, and overpayment collection management. This audit includes the following findings and associated recommendations:

- To better ensure success when privatizing the Jobs Program, the Department should provide staff and contractor training; develop monitoring tools for contract compliance, performance, and fiscal expenditures; and take necessary steps to ensure that its data is secure and accurate.
- To improve its food stamp eligibility determination error rate, the Department should ensure that local office supervisors meet case file review quotas and continue its efforts to improve its policy change notification process, and develop a management training program;
- To improve its TANF and food stamp overpayment collections, the Department should assign additional staff to process overpayment referrals, standardize its overpayment referral process, and continue its efforts to implement an electronic document-scanning system to increase case file accessibility.

In addition, the report contains Other Pertinent Information (see pages 35 through 41) on the impact of welfare reform nationally and in Arizona, and internal control issues related to recent fraud cases in which department employees illicitly obtained TANF and food stamp benefits.

Auditors used a variety of methods to study the issues addressed in the audit. Audit methods included interviews with management and staff from the Department and its Divisions of Employment and Rehabilitation Services, Benefits and Medical Eligibility, and Child Support Enforcement; and review of applicable statutes, regulations, policies, and procedures. To perform more specific audit steps, auditors used the following methods:

- To determine the Department's preparedness for the Jobs Program privatization, auditors reviewed national reports related to welfare reform and privatization of welfare services from the U.S. General Accounting Office; Mathematica Policy Research, Inc., which examined TANF privatization in six regions; and the U.S. Department of Health and Human Services, as well as a study of the Arizona Jobs Program by Abt Associates, a for-profit government and business research and consulting firm.<sup>1,2,3,4,5</sup>

<sup>1</sup> Winston, Pamela, Andrew Burwick, Sheena McConnell, and Richard Roper. *Privatization of Welfare Services: A Review of the Literature*. Washington, D.C.: Mathematica Policy Research, Inc.; May 2002.

<sup>2</sup> McConnell, Sheena, Andrew Burwick, Irma Perez-Johnson, and Pamela Winston. *Privatization in Practice: Case Studies of Contracting for TANF Case Management*. Washington, D.C.; Mathematica Policy Research, Inc. March 2003.

<sup>3</sup> U.S. General Accounting Office, Report to Congressional Requestors. WELFARE REFORM: Federal Oversight of State and Local Contracting Can Be Strengthened. GAO-02-661, June 2002.

<sup>4</sup> U.S. General Accounting Office, Report to the Chairman, House Republican Task Force on Privatization. *PRIVATIZATION: Lessons Learned by State and Local Governments*. GAO/GGD-97-48, March 1997.

<sup>5</sup> Kornfeld, Bob, and Laura Peck. *The Arizona Works Pilot Program: A Three-Year Assessment*. Cambridge, MA: Abt Associates, Inc., Feb. 2003.

Auditors also attended Jobs Program and Arizona Works management meetings and the Request for Information meeting related to the Jobs Program privatization Request for Proposals; reviewed Arizona Works' case file review outcomes; reviewed the Department's internal audits of its Arizona Works contractor and the Jobs Program's follow-up monitoring of the contractor; reviewed the Jobs Program privatization Requests for Proposals, contracts, monitoring tools, guides, and plans from other jurisdictions that privatized their TANF employment case management functions;<sup>1</sup> interviewed officials from AHCCCS and the Department of Health Services Division of Behavioral Health Services, regarding issues such as data security, monitoring practices, and its authority to withhold funds for vendor contract noncompliance; and examined Arizona Government Information Technology Agency and the Department of Administration's data security standards, and Health Insurance Portability and Accountability Act (HIPAA) security standards that apply to DHS and AHCCCS.

- To assess the adequacy of the Department's food stamp eligibility determination quality assurance process, auditors reviewed management reports detailing error rate causes and trends, and federal regulations and procedures regarding the food stamp quality control program; interviewed the federal quality control specialist for Arizona; conducted site visits to four District 1 local offices (Maricopa County) to observe eligibility interviews and gain an understanding of the overpayment referral process; and held a focus group comprising selected local office managers to determine causes for food stamp determination errors and backlogs.
- To determine the adequacy of the Department's TANF and food stamp overpayment referral and claims management process, auditors reviewed internal management and system-generated claims and collections reports for fiscal years 2000 through 2003; and surveyed each District's overpayment units to determine its process for managing and reporting overpayment referrals.

This audit was conducted in accordance with government auditing standards.

The Auditor General and staff express appreciation to the director of the Department of Economic Security and his staff for their cooperation and assistance throughout the audit.

<sup>1</sup> The states of Wisconsin and Delaware; the counties of Hennepin, Minnesota, and San Diego, California; and Texas' Lower Rio Grande Workforce Development Agency.

# FINDING 1

## Department should ensure proper oversight of privatized Jobs Program

To successfully meet the requirement to turn the State's Jobs Program over to private contractors, the Department needs to ensure that it can effectively oversee the work these contractors will perform. By statute, the Department must change the Jobs Program from a direct service provided by department staff to a contractor-operated function by July 1, 2004.<sup>1</sup> However, auditors identified several weaknesses in the Department's preparedness to ensure that privatization offers the best quality service for minimal cost. Two matters stand out as particularly important. One is the thoroughness of preparations for monitoring the contractors. The Department needs to step up its efforts to train its own monitoring staff, train contractors in complying with federal requirements, and develop specific monitoring plans. The other is effective control over data. To help protect sensitive data that will now be handled in new settings by employees who may not know the requirements for handling and securing the information, the Department needs to develop additional security controls and training requirements.

The Jobs Program must be privatized by July 1, 2004.

### Jobs Program Services and Requirements

- Services include career preparation courses, GED testing fees, and vocational training
- Program provides financial support for expenses such as child care services, tools and equipment necessary for a job, clothing, and medical or dental services
- Individual employment plans typically require a period of job searching before receiving services
- Progressive penalties are applied to participants who fail to comply with work participation requirements, ending with termination of TANF benefits for at least 1 month or until meeting compliance

## TANF recipients must participate in Jobs Program

Federal and state law require nearly all adult Temporary Assistance for Needy Families (TANF) recipients to participate in defined work-related activities in order to receive benefits. Laws 1997, Chapter 300, established work activities for Arizona consistent with federal TANF work requirements. These activities include job search, subsidized or unsubsidized

<sup>1</sup> The Forty-Sixth Legislature is considering Senate Bill 1265, which would delay the date by which the Department has to privatize the Jobs Program. If the bill becomes law, the Jobs Program privatization would begin by July 1, 2005, or July 1, 2006, depending on whether Congress reauthorizes the TANF program before or after July 1, 2004.

employment, job skills training, education, unpaid work experience, community service programs, and vocational training. TANF applicants must attend an orientation where they learn about requirements and are informed about Jobs Program services before their TANF eligibility interview. Once the Department's Family Assistance Administration determines that a family is eligible for TANF cash assistance, it sends a referral to the Jobs Program. As soon as the Jobs Program staff activate the case by pulling it from the referral file, the participant must attend a welcome meeting and an initial interview with a Jobs Program case manager. The participant and case manager conduct a job readiness assessment and formulate an employment plan that includes an employment goal and a plan for moving the individual into employment as quickly as possible. Generally, new participants spend a few weeks looking for work on their own before entering the Jobs Program training programs, such as career preparation courses and vocational training. The Jobs Program also provides GED testing fees to participants without a high school diploma or GED. As long as the client complies with program requirements, Jobs also provides a variety of other support services such as transportation assistance, clothing, vouchers, medical and dental assistance not covered by the Arizona Health Care Cost Containment System (AHCCCS), and day care registration and co-payment fees not covered by other programs. The program continues to provide some of these services, such as transportation and educational assistance, for up to 2 years after a successful participant begins earning more money than is allowed to qualify for TANF cash assistance. However, if an individual fails to comply with work requirements, the participant's TANF cash assistance grant is reduced, and after repeated instances of noncompliance, it is terminated.

## State-wide Privatization Timeline

**May 2002**—New law passed that requires state-wide privatization beginning January 2004.

**December 2002**—Department issues RFP.

**February 2003 to May 2003**—Concerns develop over possible cuts in the budget for the Jobs Program, possible federal changes in the program, and the RFP's specific provisions.

**May 2003**—Legislature extends privatization deadline until July 2004.

**June 2003**—Department withdraws RFP for reworking.

**February 2004**—Department has not yet issued a new RFP.

**July 1, 2004**—Department required by statute to implement privatization, unless deadline extended to 2005 or 2006 by Senate Bill 1265 (46th Legislature).

## Jobs Program to be privatized

Laws 2003, Ch. 223 requires the Department to privatize the Jobs Program state-wide by July 1, 2004.<sup>1</sup> Under privatization, contractors will be responsible for providing program services. The Department's own case managers currently provide this function for most of the State.

Effective administration of the Jobs Program, whether under state or contract employees, is important because it affects the amount of money the State receives from the federal government. Specifically, the Jobs Program's effectiveness in helping cash assistance recipients obtain and retain jobs affects the State's TANF Block Grant funding level. For example, good performance in areas such as job placement, job retention, and earnings gain can result in bonus awards of up to 5 percent of the State's \$222.4 million TANF Block

<sup>1</sup> The Forty-Sixth Legislature is considering Senate Bill 1265, which would delay the date by which the Department has to privatize the Jobs Program. If the bill becomes law, the Jobs Program privatization would begin by July 1, 2005, or July 1, 2006, depending on whether Congress reauthorizes the TANF program before or after July 1, 2004.

Grant. In contrast, federal TANF Rules and Regulations specify that poor Jobs Program performance, such as failing to meet the federal work participation rate or failure to submit accurate and timely reports, could potentially cost the State up to 21 percent of its adjusted grant amount.

Arizona has experimented with privatization on a limited basis since April 1999, when the Legislature established the Arizona Works Pilot Program to determine the feasibility of privatizing Arizona's administration of public assistance. Arizona Works has operated in much of the northern and eastern parts of the Phoenix metropolitan area and for 6 months in Greenlee County. A national for-profit research and consulting firm, Abt Associates, found that Arizona Works has roughly the same success in job placements and average earnings as the Department, although in fiscal year 2001, Arizona Works cost approximately 134 percent of what it would have cost the Department to provide the same services.

## Past privatization activities demonstrated oversight weaknesses

Two past problems related to the Department's privatization activities illustrate that the Department may not be fully prepared to effectively monitor the privatized state-wide Jobs Program. First, the Department's sporadic monitoring of the Arizona Works Pilot Program revealed issues of contract noncompliance and lack of information to demonstrate compliance. Second, the original Request for Proposal (RFP) issued for the state-wide program did not adequately address concerns that had been found in other states that had already privatized their programs.

**Arizona Works contract monitoring limited and sporadic**—Prior to supervisory reviews in March 2003, the Department did only limited monitoring of the Arizona Works contractor. The limited monitoring the Department did conduct revealed issues of contract noncompliance and lack of information to demonstrate compliance. Specifically:

- Internal DES audits released in 2000 and 2001 each found such weaknesses as lack of internal fiscal controls, lack of documentation for expenditures and client participation hours, and inconsistent enforcement of sanctioning procedures.<sup>1</sup> However, the Department did not monitor Arizona Works' corrective action plan and ensure that the plan adequately addressed problems found during the DES audits until a June 2003 review was conducted.

<sup>1</sup> Sanctioning is the process of taking action to reduce or eliminate assistance when participants do not comply with job search or employment requirements. In June 2003, the Jobs Program conducted its first review of processes Arizona Works implemented to comply with recommendations in the 2000 and 2001 internal audits. The review found that such processes were in place, but the Jobs Program has yet to review if the processes have eliminated the problems identified in those audits.

Disbursement of \$7.8 million in child care subsidies not monitored.

- Case reviews conducted in January-March 2003 by the Department to comply with court orders showed that the contractor failed to properly follow court-ordered requirements. Problems included lack of documentation and an inability to follow procedures designed to ensure due process in the sanctioning of cases.<sup>1</sup> Supervisory case reviews conducted in March 2003 showed similar results, as well as inaccuracies of employment and work participation data entered into the Jobs Automated System (JAS).
- In May 2003, the Department found that the contractor was not correctly providing data the Department reported to the federal government. According to department e-mail messages to the contractor, the contractor had to resubmit up to 39 weeks of employment information on more than 1,600 cases to bring those cases into compliance.
- In November 2003, the Department performed its first review of the contractor's child care functions, including child care eligibility determination. The case file review found a lack of documentation and child care request logs, a high rate of client notice errors, incorrect information entered into the Department's Child Care information system, and untimely verification of continuing eligibility.

Initial RFP lacked elements common to procurement of TANF case management services—Auditors' review of the initial RFP for state-wide privatization showed that it contained weaknesses related to liquidated damages and performance measurements. Specifically, although the U.S. General Accounting Office found that common performance measurements for state and local TANF contractors include the federal work participation rate and job retention, the Department's original RFP failed to include these measures. Further, other states' RFPs penalize contractors who fail to meet specified performance goals or provide contracted services. For example, Wisconsin assesses liquidated damages up to \$5,000 for each instance of contract failure and may withhold funds if a contractor fails to submit or comply with a corrective action plan when deficiencies are detected. The Department's original RFP included contract termination as the only penalty for contractor deficiencies. However, the severity of this penalty would deter the State from imposing it as frequently as liquidated damages. A contractor's failure to meet the federal work participation rate could result in a 5 percent reduction of the State's TANF Adjusted Basic Grant, equal to approximately \$10 million. However, the Department's original RFP would not penalize individual contractors that failed to meet the work participation rate, although the amounts received by all contractors would be adjusted by up to 5 percent to reflect the State's decrease in TANF funding. The Department should consider expanding performance measurements to include the federal work participation rate and job retention, and should assess liquidated damages for contractor deficiencies.

<sup>1</sup> The Department must ensure Jobs Program participants receive proper due process before they receive a sanction to comply with a court order in *Amanda Olea, et al. v. John Clayton, Director, Arizona Department of Economic Security*, CIV 99-106 TUC WDB.

## Department should prepare to monitor contractors

To successfully oversee a state-wide privatization program, the Department needs better monitoring procedures. It needs to develop monitoring practices that could potentially be used with Arizona Works in the short-term, then with all contractors once privatization occurs. The Department needs to address three aspects of contract monitoring as it prepares for state-wide privatization of the Jobs Program—training its own staff in contractor oversight, training contractors in procedures they will need to comply with program requirements, and developing effective monitoring plans.

**Training for staff who will monitor contractors**—The Department plans to use 13 employees to monitor contractors, but has not developed a training program for them. These individuals will need to monitor the contractors' contract compliance, performance, and fiscal expenditures. The Jobs Program has acknowledged the need to provide training to its contract managers, but has not formulated curriculum or identified trainers.

Other jurisdictions that have privatized TANF employment services have provided extensive training to their contract managers. For example, San Diego County contract managers undergo a 5-day training course on areas such as contract project planning, contracting for compliance, and contract administration. They also receive periodic training to address specific issues. Other units within the Department have more contract monitoring experience, and the Department should draw upon their expertise to develop training for the Jobs Program contract managers.

**Training for contractors**—Contractors and their staff will need to understand and follow department policies and procedures. Doing so will be important, because the State is responsible for contractor actions. Further, if the contractors do not meet federal and court-ordered standards, the State could face sanctions. In addition, to comply with the *Olea, et al. v. John Clayton, Director of the Department of Economic Security* principles of agreement, the Department must ensure that Jobs participants receive due process before eliminating their cash assistance benefits. The Department has acknowledged the importance of ensuring contractor training, but has not established a training plan.

Timely and effective training, especially at the beginning of the contractual relationship, increases the likelihood of contract compliance. Wisconsin's Department of Workforce Development requires contractors to train their staff in accordance with the Department's policies and procedures. Contractors must detail how they train employees and ensure that case managers do not manage cases until an agreed-upon level of training has been completed. Additionally, Wisconsin monitors to ensure that training does occur.

The Department must ensure that contractors comply with court-ordered standards.



The Department has at least three options for ensuring contractor staff receive appropriate training: requiring that contractors provide department-developed training, training the contractors' trainers, or approving a contractor's own curriculum. Regardless of the option chosen, the Department should review training sessions and attendance as part of its contract monitoring.

**Monitoring plans**—The Department has developed a plan, guidelines, and nearly all other tools for monitoring contractor performance of the Arizona Works contractor, which presumably could be used as a good starting point for state-wide privatization monitoring. According to the Jobs Administration's Contract Management Supervisor, a monitoring review of Arizona Works should take place in April 2004. In 2003, the Department began conducting extensive reviews of the contractor, but it did not begin developing its first monitoring tool until August 2003.

Other jurisdictions, such as the State of Wisconsin, have developed tools to monitor high-risk areas. For example, auditors in Wisconsin discovered that contractors had overcharged the state hundreds of thousands of dollars by charging the state for time spent on other projects and for questionable or unallowable costs. As a result, Wisconsin developed monitoring tools for reviewing contractors' staff time-cost allocation and expenditure receipts. During the current audit, the Jobs Program's contract management supervisor has received monitoring tools, guides, and plans used by other agencies that monitor their private TANF employment case managers, which can serve as models to guide the Department's efforts for both monitoring the Arizona Works contractors and all contractors under state-wide privatization. Because the Department is only beginning to develop these monitoring practices and instruments, it will need to refine them and develop a plan that consolidates annual and ongoing monitoring.

## Department needs to ensure the protection of Jobs Program data

The Department also needs to take steps to protect information in the Jobs Automated System (JAS).<sup>1</sup> This data must be both accurate and secure because it affects federal reports that could affect Arizona's TANF funding and includes clients' personal information, such as Social Security numbers. Adding contractors to the layers of personnel who can access this information could increase the threats to data security. Various controls are needed, such as setting minimum security standards for contractors and requiring them to implement specific procedures for reporting security-related incidents.

<sup>1</sup> The Jobs Automated System is the computer system the Department developed for tracking and managing Jobs Program employment cases. It contains personal information about each client, as well as the client's employment plan and services the client has received.

## Contractor access to data creates potential for additional risk—

Allowing outside parties to process and transmit department data poses several potential threats. First, it potentially increases data transmission between locations, creating more risk that data can be lost or intercepted. Under the original RFP, contractors would be allowed either to use department office space and its connections to the department mainframe, or to use their own office space and establish their own connection to the department mainframe; the latter option may increase the number of locations to which data will be transferred. Second, it adds contractor employees to the list of authorized users who must be screened, trained, and monitored.

The Department has already experienced at least one security breach with the Arizona Works contractor. A contractor employee was arrested for allegedly selling several printouts containing recipients' names and other personal information she had obtained from the Department's systems. The Department terminated her access to the system, and she never returned to Arizona Works.

## Security controls need to ensure that data is accurate and secure—

To protect JAS data security, the Department needs to take several steps. These steps may vary somewhat depending on the specific assessed risk—for example, whether the contractor is working in department space or will be obtaining and using the data at another site. In general, the steps should consist of the following:

- **Defining security standards**—Although the Department requires all contractors to complete a data-sharing agreement, the document contains only general security language. The Department has never prescribed specific security requirements nor monitored the security practices of the Arizona Works contractor. Integrity of the system and its data can be better ensured if minimum security standards are met and contractors and their staff understand security policies. Some common security standards recommended by the Arizona Government Information Technology Agency (GITA) include firewall technology, virus protection, and minimum password requirements. Other state agencies, such as the Department of Health Services and AHCCCS, and other states, such as Wisconsin, provide minimum security requirements for vendors that provide Jobs Program services.
- **Requiring contractors to conduct security assessments**—Conducting security audits or assessments to monitor security processes, events, and policies, and determining if proper security is established and maintained is a practice recommended by GITA.

The Department should improve internal controls to prevent data security breaches.

- **Requiring contractors to formulate policies on key security issues**—These policies would cover such areas as incident reporting, limiting access to cases and screens as appropriate, inventory listing, and review of access logs.<sup>1,2</sup> GITA recommends these procedures as well.
- **Developing monitoring and reporting procedures**—Both the Department and the contractor should monitor access logs and complete incident reports from such monitoring. Currently, JAS cannot track its use history. The Department's information technology staff reported that, with current staffing and workload levels, it would take about 6 months to program this function into the system. As resources become available the Department should undertake this project.

To help ensure that data is adequately secured, the Department should review compliance with these requirements after initially awarding the contract and on an ongoing basis.

**Contractor employees should receive security training**—The Department does not have a department-wide policy for requiring and ensuring security training of contractors or their employees. According to Jobs Administration data security officials, it has never verified that Arizona Works employees have received such training. A lack of security awareness and training decreases an entity's ability to avoid and recognize security breaches. The Department's Division of Child Support Enforcement (DCSE) has developed a computer-based training module to train its employees and those of its contractors. During the 30-minute training, an individual must pass a series of quizzes, after which a printout is generated and sent to DCSE, which then issues the individual a user name and password. The Department should require that contractors and their employees receive this same training, adapted to the Jobs Program, on an annual basis.

<sup>1</sup> Security incidents occur when any person who, without authority or in excess of authority, accesses, alters, damages, or destroys an IT device (server, storage, or client), network, computer applications system, or data; knowingly obtains information that by law is to be kept confidential; or introduces a computer contaminant (virus) into any IT device or network.

<sup>2</sup> Access logs register access or attempted access to screens and files within a system, creating a history track. Typically, these logs will contain access by types of users, servicing activities, failed sign-on attempts, error/exception conditions, and sufficient information to identify individual user IDs, resources, and information accessed, access paths, and patterns of access.

## Recommendations

1. The Department should include performance measurements such as the federal work participation rate and job retention in the new RFP. The Department should also assess liquidated damages for vendor deficiencies as determined by the Department.
2. The Department should ensure that staff who will perform contract management functions receive training targeted toward contract compliance, performance, and fiscal monitoring. The Department should identify resources that could provide help in designing and teaching these classes, and develop its curriculum.
3. The Department should develop a training plan so that contractors and their employees are aware of necessary policies concerning case documentation, JAS input, and other matters. The Department should monitor that such training takes place.
4. The Department should implement its newly developed plans to monitor contract compliance beginning with the monitoring review of Arizona Works in April 2004.
5. The Department should ensure that data is secure and accurate by doing the following:
  - a. Define and require minimum security standards for contractors, allowing for variation according to assessed risk;
  - b. Require security audits or evaluations of contractors, possibly requiring contractors to procure an independent firm to perform the audit;
  - c. Require contractors to formulate policies that the Department would approve, such as log access review, incident report alerts, limiting access to cases and screens as appropriate, and inventory listing;
  - d. Modify JAS to include the ability to maintain access logs;
  - e. Monitor access logs and complete incident reports from such monitoring and require the contractor to do the same;
  - f. Require contractor employees to undergo annual security awareness training, possibly using a computer-based approach already developed by the DCSE; and
  - g. Review compliance with the security requirements after the initial contract is awarded and on an ongoing basis thereafter.



# FINDING 2

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## Department can more effectively manage its food stamp eligibility determination process

Although the Department's Division of Benefits and Medical Eligibility (Division) successfully lowered its food stamp eligibility determination error rate, it needs to take steps to counter potential future increases in this rate. The Division successfully reduced its food stamp error rate from 15.42 percent in 1994 to 5.27 percent in 2002, and has received several bonuses from the federal government for keeping the error rate below federal thresholds. However, the Division's food stamp error rate for federal fiscal year 2003 is expected to have increased—not enough to cause federal penalties, but these increases could result in a potential loss of future bonus monies.<sup>1</sup> According to division management, increasing total caseloads coupled with reductions in eligibility determination staff have negatively affected the error rate. Using a focus group of local office managers within the Division, auditors identified several areas in which the Division can more effectively manage its eligibility determination process. These include more consistent supervisory review of case files, improved processes for communicating policy changes to local staff, and establishment of a management training program for local office managers.

## Accuracy of eligibility determinations affects federal funding

The U.S. Department of Agriculture, Food and Nutrition Service (USDA) requires states to implement quality control programs to monitor food stamp error rates and has established performance measures, which can result in sanctions or bonuses, to encourage states to limit eligibility determination error rates. To ensure that eligibility determinations are accurate and do not adversely affect federal funding, the Division implemented a quality assurance program that consists of two main functions: (1) supervisor case file reviews, and (2) comprehensive error rate analysis and reduction activities.

<sup>1</sup> The USDA is required to certify the fiscal year 2003 food stamp error rates by June 2004.

The USDA has established error rate performance measures.

**States must evaluate their accuracy in eligibility determinations**—The USDA requires states to implement a quality control program to identify and reduce program deficiencies, such as eligibility determination error rates, for their respective food stamp programs. The goal of the quality control program is to ensure that states spend food stamp benefit monies in accordance with federal regulations.

To encourage states to implement effective quality control programs, the USDA established performance bonuses and sanctions based on error rate limits. Prior to the federal fiscal year 2003 quality control review period, federal regulations established a 5.9 percent payment error rate ceiling. If states kept their payment error rates below 5.9 percent, they became eligible for performance bonuses.<sup>1</sup> Conversely, if states report consistently high error rates, the USDA may impose sanctions. For example, the USDA fined the State of California more than \$62 million for its excessive federal fiscal year 2002 error rate.

The USDA's food stamp quality control program requires each state to select and audit a statistically valid sample of cases from active food stamp recipients and applicants who were denied benefits. The Division's Office of Program Evaluation (OPE) conducts this review. Although not required to do so, the Division follows a similar process for the State's TANF program.<sup>2</sup>

**Quality assurance program designed to limit errors**—In Arizona, eligibility determinations are made by eligibility interviewers in local offices. These interviewers determine whether an applicant is eligible to participate and, if so, the level of benefits that applicant is eligible to receive, using such supporting documentation as birth certificates, bank statements, and employment records.

The Division has established a quality assurance program to identify, monitor, and limit errors in the work of these interviewers. An eligibility determination error occurs when a client is denied benefits to which he or she is entitled or receives more or fewer benefits than allowed under state and federal laws. The Division continually monitors the accuracy of eligibility determinations through error rates. It calculates the error rate by dividing the total benefit dollars issued in error by the total benefit dollars issued based on its sample of cases. The quality assurance program has two main components:

## Local Office Positions

**Eligibility Interviewer (EI)**—Interviews applicants and reviews documentation, determines eligibility for TANF, food stamps, and medical assistance programs.

**Supervisor**—Ensures that EI's have correctly applied federal and state eligibility criteria and have met application processing timeliness performance standards.

**Local Office Manager**—Coordinates staff resources to meet the Division's timeliness and eligibility determination accuracy goals.

<sup>1</sup> The federal 2002 Farm Bill eliminated the 5.9 percent standard and established new standards for bonuses and liabilities. Specifically, effective in fiscal year 2003, a state may only be penalized for its food stamp error rate if there is a 95 percent statistical probability that its error rate has been greater than 105 percent of the national average for 2 consecutive years. The 2002 Farm Bill also established a performance system that will award \$48 million in bonuses each year to states with high or improved performance for actions taken to correct errors or to improve eligibility determinations, or for other activities that demonstrate effective administration of the Food Stamp Program.

<sup>2</sup> In 1996, TANF regulations eliminated the quality control requirements established under the Aid to Families with Dependent Children (AFDC) program. However, the Division has continued the quality control program for TANF.

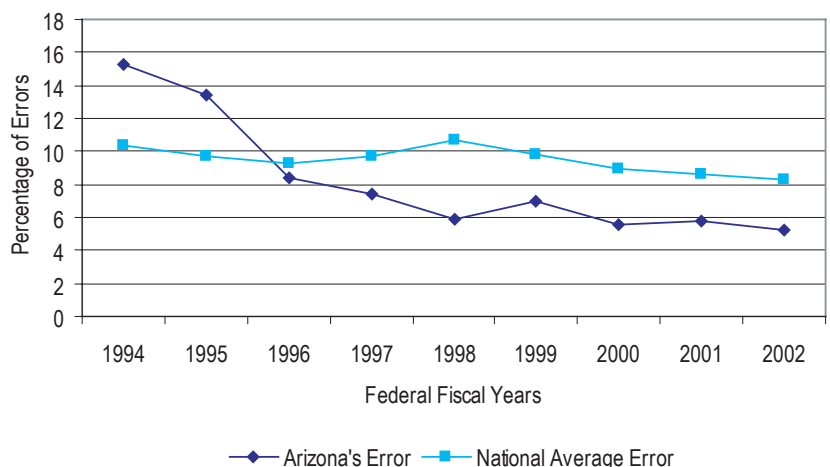
- **Supervisor case file reviews**—The Division requires supervisors to review selected case files to ensure that the interviewer correctly determined the client's eligibility and benefit level. To minimize errors, the Division encourages supervisors to conduct this review before benefits are issued. In October 2002, the Division implemented an automated system to monitor the results of these reviews, providing detailed information about the most common types of errors and allowing management to target these types of errors.
- **Error rate analysis and review**—In addition to conducting the annual quality control review to determine the Division's TANF, food stamp, and general assistance error rates, OPE provides program managers with reports detailing the reasons for client-caused errors and division-caused errors. According to a department official, local offices with consistently high error rates are designated as "state focus offices" and receive additional OPE review. Additionally, the Division established a quality control review committee to review potential errors that are identified through OPE's quality control reviews.

## Despite past success, improvements are needed to reduce eligibility determination errors

The Division's success in reducing its food stamp error rate in the late 1990s and early 2000s resulted in federal bonuses, but the error rate trends for 2003 indicate a potential increase. In the 1990s, the USDA fined the Division more than \$13 million for failing to meet federal error rate standards. Under an agreement with the USDA, the Division agreed to invest \$1 million into its quality assurance program in exchange for the USDA's agreeing to waive almost \$13 million if the Division kept its food stamp error rates below the national average. The Department's efforts succeeded in reducing the error rate from 15.42 percent in 1994 to 5.27 percent by 2002 (see Figure 2). For Arizona's federal fiscal year 2002 performance, USDA awarded the Department a more than \$3.8 million bonus and identified the quality assurance program as a best practice

The Division successfully reduced its food stamp error rate.

Figure 2: Error Rates in Food Stamp Benefit Payments  
Federal Fiscal Years 1994 to 2002



Source: Auditor General staff analysis of information provided by the Department of Economic Security's Office of Program Evaluation and the U.S. Department of Agriculture.



model. However, according to the Division's internal reports, the food stamp error rate for 2003 is expected to increase.<sup>1</sup>

## Quality assurance program can be improved

### Local Office Manager Focus Group

Auditors conducted a focus group composed of ten local office managers from District 1 to solicit input regarding the nature and cause of errors and identify reasons why eligibility determination error rates are increasing.

The focus group identified several barriers to accurate eligibility determinations, including limited resources, inadequate staffing levels, frequent changes to complex policies, and the lack of management training. The managers also discussed techniques they employ to help identify and prevent eligibility determination errors, including supervisor case file reviews.

According to division management, increasing caseloads coupled with reductions in eligibility determination staff have negatively affected eligibility determination error rates. However, the Division can improve its current quality assurance program to help limit eligibility determination errors. Auditors conducted a focus group comprising local office managers to identify effective components of the Division's quality assurance program as well as suggestions for improving the management of accurate eligibility determinations. Based on the results of the focus group and additional audit work, auditors identified three main areas in which the Division can more effectively manage the program: (1) supervisor case file reviews, (2) policy change notifications, and (3) local office manager training.

**Increasing supervisor case file reviews**—Although the Division requires each supervisor to review 35 case files per month, its internal system indicates that a majority of supervisors have not consistently reviewed the required number of cases. According to division management, increasing caseloads have been a contributing factor in the shift of supervisor focus away from case reviews. However, local office managers reported that these reviews are an important way to identify eligibility determination errors in time to correct them before benefits are issued. Without consistent case file reviews, supervisors cannot effectively identify and prevent eligibility determination errors. Further, the U.S. General Accounting Office reported that supervisor case file reviews are one of the most effective ways to reduce error rates.<sup>2</sup> Therefore, the Division should continue its efforts to ensure that supervisors review the required number of case files by monitoring the monthly reports that detail the number of case files reviewed by supervisors. The Division can use these reports to identify local offices that are unable to meet the monthly quotas and should take steps to improve these offices' performance. Additionally, the Division should identify local offices that have established effective procedures for ensuring that supervisors consistently conduct case file reviews and share these procedures with all offices.

**Providing better notice of policy changes**—Local office managers identified frequent policy changes and clarifications as a significant barrier to accurate eligibility determinations. Eligibility interviewers in local offices must understand and apply

<sup>1</sup> The USDA is required to certify the fiscal year 2003 food stamp error rates by June 2004.

<sup>2</sup> U.S. General Accounting Office (GAO). *Food Stamp Program: States Seek to Reduce Payment Errors and Program Complexity*. GAO-01-272, January 2001.

complex policies and procedures when determining TANF and food stamp eligibility, but these policies and procedures are subject to change through federal policy clarifications, state legislation, and internal management decisions. During calendar year 2003, for example, the Division's policy unit issued 93 policy notifications.

Improvements can be made in the quality of the notifications provided to local office personnel. Specifically, the Division notifies local office staff of policy change through a standard e-mail, regardless of the policy notification's nature or significance. The notifications do not clearly specify whether the policy notification is a minor internal clarification or a major change to eligibility determination criteria. The Division is currently attempting to improve its policies and procedures for communicating policy changes. For example, in February 2004, the Division implemented a new policy requiring that local office managers review and discuss new policies with their staff within one week of their issuance. Further, each employee is to sign an acknowledgement to ensure that he or she has received and reviewed the policy.

**Creating training programs for local office managers**—Although the Division has established comprehensive training programs for eligibility interviewers and supervisors, it has not developed a management training program for its local office managers. Several local office managers who participated in the focus group stated that they did not receive formal training regarding time and employee management, report use and management, and ways to balance increasing caseloads with reduced staff. The Division is in the process of developing a training program for local office managers.

## Recommendations

1. The Division should continue its efforts to ensure that supervisors review the required number of case files by monitoring the monthly case review reports, identifying local offices that are unable to meet the monthly quotas, and taking steps to improve these offices' performance. In addition, the Division should identify local offices that have established effective procedures for conducting consistent case file reviews and share these procedures with all offices.
2. The Division should continue its efforts to improve its process for communicating policy changes to local office staff. Specifically, the Division should continue its efforts to update its policies and procedures. It should also continue its efforts to identify local offices that have developed effective processes for communicating policy changes to their staff and should share these processes with all offices.
3. The Division should continue its efforts to develop a training program for local office managers. The Division should ensure that the curriculum for this program includes classes on time and employee management, report use and management, and balancing increasing caseloads with reduced staff.



# FINDING 3

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## Department should improve management of its benefit overpayment referrals process

Although the Department's Office of Accounts Receivables and Collections (Collections Office) adequately recovers overpayments of TANF and food stamp benefits when it receives notifications of the overpayments, many other overpayments may be going unrecovered because they are not referred to the Collections Office on a timely basis. Internal reports compiled by the Division of Benefits and Medical Eligibility (Division) indicate that its offices have accumulated a backlog of thousands of possible overpayments, the value of which is likely in the millions of dollars. However, the process for tracking and reporting overpayment referrals and claims is unreliable and prone to inaccuracies. Additionally, in the Division's largest district, many possible overpayments cannot be confirmed because local offices are unable to locate needed case files. The Division needs to continue its current efforts to reduce the backlog, address the problem with lost case files, and improve its process for tracking and reporting possible overpayments.

## Effective recovery of overpayments requires timely collection efforts

Overpayments occur when clients receive more TANF or food stamp benefits than they are entitled to under federal and state eligibility criteria. Benefit overpayments can result from (1) client error, for example when a client fails to report that he/she has a new job or other new source of income, (2) department error, such as mistakes in calculating benefits, or (3) fraud, as when a client intentionally misrepresents income or household composition. Timely processing of such cases increases the likelihood that the client will pay it back. The U.S. Department of Agriculture (USDA) also encourages states to process potential cases of overpayments no more than 3 to 6 months after it establishes the claim to increase the potential for collection.

Inaccurate eligibility determinations can result in overpayments.

The processing of potential overpayments involves personnel in several different offices. Within the Division, Eligibility Interviewers (EIs) identify potential benefit overpayments and are responsible for referring them to the districts' designated overpayment units. Potential overpayments are also identified through quality control audits, management reviews, and special fraud investigations. Overpayment specialists within these units then review the file and other supporting documentation (such as employment records) to determine if there is a legitimate overpayment claim. According to the Division's policies, overpayment specialists should not pursue food stamp referrals if the overpayment is less than \$125, or if the specialist is unable to verify the information in the overpayment referral. They submit valid claims to the Collections Office. The Collections Office notifies the client of the overpayment or, in cases of suspected fraud, refers the overpayment claim to the Department's Office of Special Investigations for further investigation. Once they are notified of the overpayment, clients have the right to request a fair hearing through the DES Office of Appeals.

During the past 4 federal fiscal years, the Collections Office has complied with federal food stamp overpayment collections standards.<sup>1</sup> In state fiscal year 2003, the Collections Office collected nearly \$2.7 million, while only about \$2.3 million in new food stamp overpayment claims were established during that year. In state fiscal year 2000, the Collections Office collected more than \$2.6 million, compared to more than \$2.3 million in new food stamp overpayment claims established during that year. The Collections Office is able to collect more claims than it establishes during a fiscal year because there is an outstanding balance of overpayment claims (see Table 3). This balance is an accumulation of both current and past debt.

The federal government has not established a standard for TANF collections, but in state fiscal year 2003, the Office collected slightly more than \$1.7 million, compared to the nearly \$1.9 million in TANF and AFDC overpayment claims established during that year.

Federal food stamp regulations allow states to retain a certain percentage of the collected overpayment monies. The percentages are based on the nature of the overpayment—client error, agency error, or fraud:

**Table 4:** Program Overpayment Balances as of June 30, 2003

Program	Accounts Receivable Balance	Number of Active Claims	Average Amount per Active Claim
Food Stamps	\$ 8,889,738	12,594	\$ 706
AFDC <sup>1</sup>	5,867,784	4,328	1,356
TANF <sup>2</sup>	<u>8,425,540</u>	<u>12,608</u>	668
Total	<u>\$23,183,062</u>	<u>29,530</u>	

<sup>1</sup> Although the Aid to Families with Dependent Children Program (AFDC) ended in August 1996, the U.S. Department of Health and Human Services requires states to continue to collect outstanding overpayment claims for this program until the full amount is repaid. For example, the Collections Office continues to collect on one AFDC overpayment that was established in 1969.

<sup>2</sup> The Temporary Assistance for Needy Families program began on August 22, 1996.

Source: Auditor General staff analysis of the Monthly Overpayment Collections Report for June 2003, provided by the DES Office of Accounts Receivable and Collections.

<sup>1</sup> Prior to federal fiscal year 2002, federal guidelines required states to maintain a food stamp overpayment collection rate of 72 percent. The federal government determined the states' collections rates by dividing the total claims collected during the fiscal year by the total claims established during the fiscal year. In federal fiscal year 2002, the USDA established new standards for collections that include several measures of effectiveness. In fiscal year 2003, the USDA rated Arizona's food stamp collections as above average.

- If the overpayment monies collected are due to errors made by the agency (DES), then 100 percent of the collection amount goes to the federal government.
- If the overpayment monies collected are due to errors made by the client, then 80 percent goes to the federal government and the remaining 20 percent goes to the State.
- If the overpayment monies are due to client fraud, then 65 percent goes to the federal government and the remaining 35 percent goes to the State.

In federal fiscal year 2003, the State retained over \$420,000 in food stamp overpayment recoveries. All TANF overpayment monies are retained by the State and used for program costs, regardless of the nature of the overpayment.

## Many potential overpayments are not being checked or referred

The Division has not established an effective and reliable process for managing its overpayment referrals, which are used to identify potential overpayment claims. Internal reports indicate that, as of December 2003, the Division had a backlog of more than 7,700 food stamp and TANF overpayment referrals that had not yet been assessed and confirmed as claims. After audit work was conducted, the Division reported it had further reduced its backlog to about 1,800 as of February 2004. However, because the Division does not have a reliable system of tracking and reporting overpayments, auditors were not able to verify the size of the backlog. Improvements are needed in three areas—more timely processing of potential overpayments, implementation of an automated system for tracking and reporting referrals and claims, and development of supporting systems for making case information more readily available to overpayment investigators.

The Division has a backlog of overpayment referrals—The Division's overpayment reports indicate that, as of December 2003, there were more than 7,700 pending TANF and food stamp overpayment referrals that had not been assessed and confirmed as claims. Over 86 percent of the total pending overpayment referrals reported in December 2003 were considered backlogged.<sup>1</sup> Although auditors were able to confirm that the Division has a substantial backlog of overpayment referrals, the true extent of the backlog could not be verified due to the Division's unreliable process for tracking and reporting overpayments. The Division's reports also indicate that the backlog has increased substantially in recent years. Specifically, the number of reported pending overpayment referrals grew from more than 5,000 in June 1999 to more than 13,000 in July 2003. Between September and November 2003, several

The Division had more than 13,000 pending overpayment referrals.

<sup>1</sup> According to division management, overpayment referrals that are not processed within 30 days are considered backlogged. However, the Division tracks overpayment referrals on a 45-day standard.

overpayment units reported that their backlog included referrals dating back several years. For example, one overpayment unit reported that it had referrals dating back to 1997. According to division management, the backlog resulted from a shift in staff resources to respond to increasing caseloads. Local office managers reassigned overpayment specialists to help manage the caseloads.

At the request of division management, some district managers have assigned staff to overpayment specialist positions in an effort to reduce the backlog. Specifically, according to internal reports, the number of overpayment specialists state-wide has increased from 19 prior to January 2003 to 44 as of December 2003. As a result, the Division was able to reduce its pending referrals by more than 5,000. The Division reports it has reduced its backlog by almost 6,000 more after audit work was conducted. Therefore, the Division should continue to assess its staffing, and as resources permit, it should assign extra staff to help address the overpayment backlog.

As mentioned in the previous section, it is important that the Division process referrals in a timely manner to increase the likelihood that the overpayment will be identified and repaid. Further, overpayment referrals represent potential dollars that are owed to the State's TANF and Food Stamp Programs. While no comprehensive estimate is available of the amount of money involved in these backlogged cases, based on analysis of the Division's state fiscal year 2003 internal overpayment reports, auditors estimate that the approximately 7,700 referrals could potentially be worth approximately \$4 million. However, given that the Division does not generally pursue half of its overpayment referrals because of the low dollar value of them or the inability to verify the information in the referral, the actual dollar value of the referrals is most likely closer to \$2 million. After audit work was conducted, the Division reported that it further reduced its referral backlog to approximately 1,800 as of February 2004. These referrals had a likely value of about \$500,000.

**Lack of reliable tracking system limits ability to effectively monitor the backlog**—Auditors could not confirm the reliability of the reported backlog, in large part because several of the Division's largest overpayment units do not reliably and accurately track their overpayment referrals. Several overpayment supervisors reported that their tracking processes are labor-intensive and prone to error. For example, after auditing the number of referrals in its files in July 2003, one overpayment unit discovered that it had underreported its pending overpayment referrals by more than 700.

To address this problem, according to division management, the Division's IT unit has developed an automated system for tracking and reporting overpayment referrals and claims. Division management stated that this system will be implemented in 2004 and funded with the monies from its operating budget.

Some overpayments are dropped because of inaccessible case files—Separate from the issue of backlogged referrals, some overpayment units also reported dropping a substantial portion of the cases they received from local offices—in some cases, because the necessary files could not be located. State-wide, approximately 50 percent of overpayment referrals were not pursued during fiscal year 2003. One overpayment unit in District 1 reported that it did not pursue over 70 percent of its overpayment referrals during fiscal year 2003. According to the overpayment unit supervisor, about half of these referrals were dropped because the local office could not provide the case file.

The Division's policies state that overpayment specialists should not pursue food stamp referrals if the overpayment is less than \$125, or if the specialist is unable to verify the information in the overpayment referral. However, according to division management, the Division does not centrally track the reasons why overpayment units do not pursue overpayment referrals.

Although a survey of the Division's overpayment units revealed that some referrals may be dismissed because the eligibility interviewer did not apply the policy correctly, several of the Division's largest overpayment units reported that the most common reason for dismissal was the local offices' inability to provide case files. According to one local office manager, a reduction in clerical staff coupled with increasing caseloads complicated the management of case files. For example, this manager said at least 500 of the office's more than 7,000 case files were stacked in boxes because the office did not have clerical staff to file them. To eliminate the need to manage and file thousands of paper case files, division management has developed a proposal to implement an electronic document-scanning system. The Division would use some of the \$3.8 million in federal bonus monies it received for its low 2002 food stamp error rate to fund this project.

## Recommendations

1. The Division should continue to assess its staffing and, as resources permit it, should continue to assign extra staff to help address the overpayment backlog.
2. To standardize its process for managing overpayment referrals, the Division should continue its efforts to implement an automated system for tracking and reporting overpayment referrals and claims, including the reasons referrals are not pursued.
3. To help the Department collect more overpayments by limiting the number of overpayment referrals that are dropped due to inaccessible case files, the Division should continue its efforts to plan to implement an electronic document-scanning system.





# OTHER PERTINENT INFORMATION

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During the audit, auditors developed information about the impact of welfare reform nationally and in Arizona, and recent welfare-related employee fraud cases.

## Impact of welfare reform nationally and in Arizona

In 1996, the face of welfare programs changed drastically across the nation with the creation of the Temporary Assistance for Needy Families program (TANF). This program focused heavily on moving recipients into jobs and creating more stable family structures. The Department operates the State's version of this program, which operates with a combination of federal and state funding. As of March 2002, recipients received a monthly average cash assistance amount of \$272.23 per family (33rd nationally), compared to the national average of \$412.40. Between 1996, when the new program began, and March 2002, Arizona's welfare caseload fell by 39.2 percent (42nd nationally in terms of the size of the caseload reduction). However, Arizona's caseload increased by 20.1 percent in the following year, while caseloads declined 2.0 percent nationally. According to national statistics, welfare reform has had a positive impact on family income. Auditors were unable to obtain data to show the effect for Arizona alone.

**Welfare reform implemented nationally**—In 1996, the Personal Responsibility and Work Opportunity Reconciliation Act (welfare reform), created TANF to replace the old welfare system, Aid to Families with Dependent Children (AFDC). Welfare reform's primary purpose was to "end the dependence of needy parents on government benefits by promoting job preparation, work, and marriage" (HR3734). Under welfare reform, states receive an annual block grant to administer several welfare programs. States have significant flexibility in allocating block grant funds and designing eligibility criteria, benefit rules, and benefit amounts. Additionally, welfare reform requires that those receiving cash assistance participate in state-defined work activities within 24 months of cash receipt unless the state exempts the individual from work requirements. Recipients are subject to a 5-year lifetime limit with limited exceptions, such as for state-defined hardship. The federal work participation rate, which measures the number of cash assistance recipients participating in work activities, is the primary performance measurement.

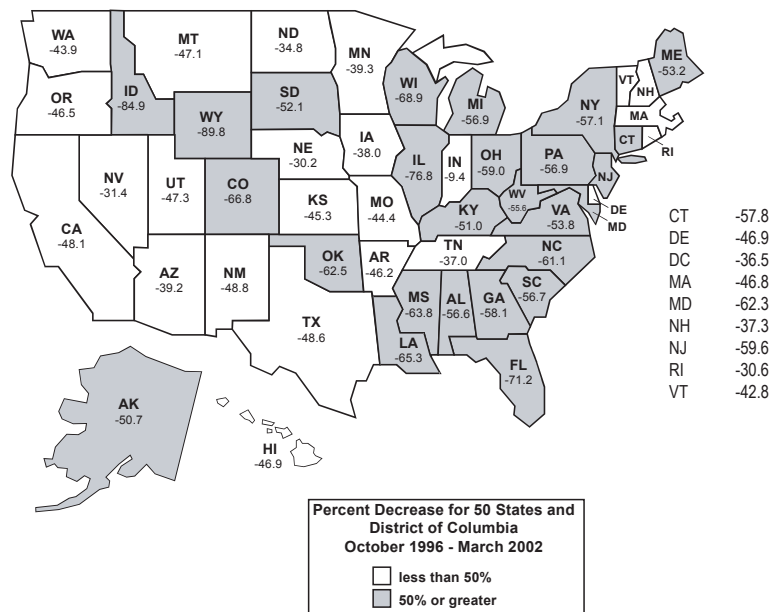
Department administers Arizona's program—The Department implemented welfare reform under a program called EMPOWER Redesign. The State uses the block grant funding for its TANF, Jobs Program, and Child Care Assistance programs. Some important features of Arizona's program are as follows:

- **Work-first orientation**—Participants must begin work activities as soon as Jobs Program staff activate their case. According to department officials, participants usually start with a job search during the first several weeks of employment service assistance. As is typical of most states, Arizona progressively sanctions recipients who fail to participate in work activities by reducing their cash assistance.
- **Cash benefit amount**—As of March 2002, Arizona's TANF recipients received a monthly average of \$272.23 per family, compared to the national average of \$412.40. Arizona's average monthly cash assistance payments rank 33rd nationally. Arizona's amount is based on raising eligible families' income to 36 percent of the 1992 Federal Poverty Level.
- **Family benefit cap**—Arizona does not allow for a cash increase for an additional child born to a family receiving cash assistance, except under very strict conditions. Seventeen other states follow a similar policy. The majority, 27 states, allow a normal cash increase for additional children, while the remaining 5 states allow a partial increase.

Arizona's caseload reduction less than most states—Since 1996, when TANF began, the average number of AFDC/TANF families nationally fell from more than 4.5 million in federal fiscal year 1996 to less than 2.1 million during the first half of federal fiscal year 2002. Figure 3 (see page 37) illustrates the state-by-state change in caseload. Studies have shown that welfare reform played a substantial role in this reduction, although the economy also played an important role. During this time, Arizona's caseload fell from 63,404 to 38,578. This 39.2 percent reduction was 42nd nationally—that is, 41 states had greater percentage reductions than Arizona's. Further, between March 2002 and March 2003, while caseloads declined 2 percent nationally, Arizona's caseloads increased 20.1 percent to 47,302. According to the Department's welfare reform report for fiscal year 2003, Arizona's population growth and a slow economy were major factors in its increased caseloads.

Reduced spending has allowed Arizona to use TANF resources in subsequent years—States spend both federal TANF money and state funds on welfare programs. The federal grant funds the majority of program expenditures, and its basic contribution has remained unchanged since the program began in 1996. This federal aid comes in the form of a block grant, and states are not required to spend the entire amount. Given the drop in the welfare caseload, Arizona, like most states, built up a reserve balance in the first years of the program. Arizona had a balance of almost \$86 million in unspent TANF block grant funds at the beginning of

Figure 3: Percentage Reduction in Number of AFDC/TANF Recipients  
August 1, 1996 through March 31, 2002



Source: Auditor General staff analysis of information on the U.S. Department's HHS TANF 5th Annual Report to Congress, February 2003.

fiscal year 2002, nearly \$69 million at the start of fiscal year 2003, and an estimated \$16 million at the start of fiscal year 2004. Like many other states, Arizona has used these reserves in recent years. Arizona will nearly exhaust the remaining surplus by the end of fiscal year 2004.

Arizona will nearly exhaust its TANF surplus in 2004.

Several other government subsidies for low-income families are now being expended at a much greater rate. For example:

- Child care subsidies at state and federal levels grew from about \$6.6 billion in 1999 to nearly \$10.2 billion in 2002. Falling caseloads have freed up TANF dollars, allowing TANF fund transfers to child care to grow from \$180 million in 1997 to \$3.5 billion in 2000. In Arizona, day care subsidies and transitional child care expenditures have increased from an approved amount of more than \$60 million in fiscal year 1997 to nearly \$149 million approved for fiscal year 2004, including monies from TANF, the federal Child Care and Development Fund, and the State General Fund. In fiscal year 1997, more than \$19 million of Arizona's child care funding came from the General Fund, and in fiscal year 2004, approximately \$31 million in General Fund monies were appropriated.

- The Earned Income Tax Credit (EITC) is a federal income tax credit for low income working individuals and families. The credit is reduced as families earn too much money, or as families work too little and thereby earn less money. It varies according to income level and family size. For example, in 2003, a single mother with two children earning between \$10,400 and \$13,550 was eligible for the largest credit of \$4,204. In 2001, more than \$33 billion in EITC was distributed to more than 19.5 million tax returns. This represents about a 300 percent increase over the \$7.5 billion spent in 1990.

Arizona's work-related activities parallel those of other states—TANF promotes work among welfare recipients by requiring states to meet work participation rates, which begin at 50 percent, but can be adjusted downward in accordance with a state's caseload reduction. In federal fiscal year 2001, the national participation rate was 34.4 percent; Arizona's rate was very similar at 32.9 percent. Nationally, more than half of welfare recipients leave assistance because of employment or increased earnings; a department study found that the figure for Arizona was 54 percent.

Family income has increased, though amounts for Arizona are not available—According to federal studies, welfare reform has had a positive impact on family income. Specifically:

- Average monthly earnings for employed welfare recipients rose 49 percent, from \$466 in federal fiscal year 1996 to \$686 in federal fiscal year 2001;
- Child poverty fell by 20 percent during this same time period; and
- Average earned income for single mothers in the lowest fifth income bracket increased by 70 percent, from \$1,740 to \$2,960 between federal fiscal years 1996 and 2000.

Auditors were unable to obtain figures showing how income levels had changed for recipients in Arizona.

While incomes have increased, moving from welfare to work does not guarantee that mothers will be able to lift their families out of poverty. In Arizona, the average hourly wage at the time of job placement in state fiscal year 2003 was \$7.75. This wage is somewhat higher than the national average. For example, a study of 17 states and Washington, D.C., conducted in 2001 reported that employed former welfare recipients averaged about \$7.41 per hour, and in several states averaged 36 hours per week or less, yielding a monthly income of about \$1,150 or less, below the federal poverty line for a family consisting of a mother and two children (about \$1,200).

TANF recipients' jobs may not lift them out of poverty.

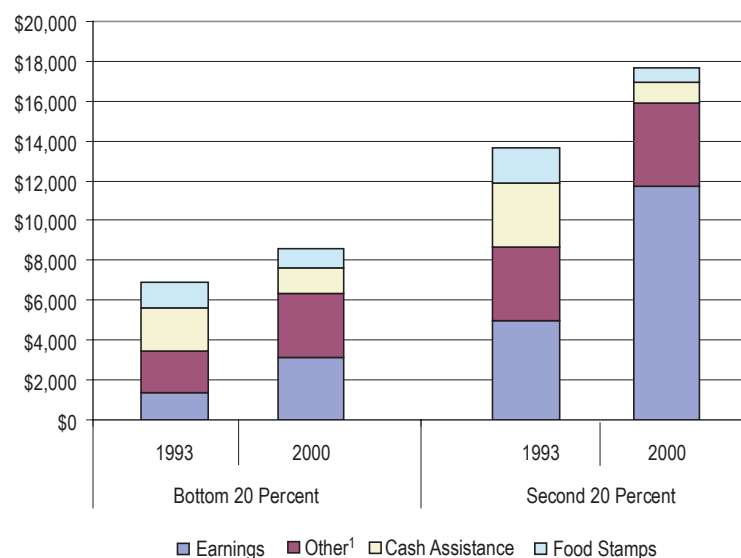
For many who leave welfare rolls, other government support remains an important source of income. Those who leave welfare may remain eligible for other services such as food stamps, Medicaid, the EITC, subsidized school meals, housing, and day care (to see how several of these subsidies augment income, refer to Figure 4). Food stamp and Medicaid usage rates increased among those who left welfare from 28 and 40 percent, respectively, in 1999 to 35 and 48 percent, respectively, in 2002. A recent National Conference of State Legislatures report stated that in Colorado, between 1997 and 1999, only 38 percent of single parents who left welfare had an income above the poverty level.<sup>1</sup> However, when these other government subsidies were included, 59 percent of the families who filed taxes in 2000 had income above the poverty level.<sup>2</sup> Families who receive government benefits after leaving welfare are less likely to return.

National studies also show that a portion of those who leave welfare return to welfare, or remain off welfare and without employment. These two groups have grown from about 30 percent of persons leaving welfare between 1997 and 1999 to 39 percent of those leaving between 2000 and 2002.

## Arizona is one of few states with family stabilization programs—

Another welfare reform objective is to encourage the formation and maintenance of two-parent families. In its 5th Annual TANF Report to Congress, the U.S. Department of Health and Human Services reports that only 8 percent of children in two-parent married households live in poverty, compared to 35 percent of those raised in single-parent households. According to the report, states generally have not developed programs intended directly to help families form or strengthen marriages. However, some states, including Arizona, Michigan, New Mexico, Oklahoma, and Utah, are beginning to make TANF-funded services available to help strengthen marriages. The report specifically cites Arizona's Marriage and Communication Skills Commission, which reviews and approves funding requests from community-based

**Figure 4:** National Average After-Tax Income of the Poorest Households Headed by Women with Children Years Ended June 30, 1993 and 2000



<sup>1</sup> "Other" includes income from child support, property, other cash transfers, estimated values of free or reduced-price school lunches and housing subsidies, and the Earned Income Tax Credit.

Source: Auditor General staff analysis of data in *Welfare Reform and Beyond: The Future of the Safety Net*, Brookings Institution, 2002, pp.15-16.

<sup>1</sup> Jarchow, Courtney. *Employment Experiences of Former TANF Recipients*. Denver: National Conference of State Legislatures, May 2002..

<sup>2</sup> Wilkins, Andrea. *Use of Non-cash Supports by Former TANF Recipients*. Denver: National Conference of State Legislatures, July 2003.

marriage and communication skills programs. In addition, Arizona has developed and produced a marriage handbook that it distributes to couples who apply for a state marriage license.

## Employee fraud

During fiscal year 2003, the Department investigated and substantiated 13 welfare-related employee fraud cases. The Division of Benefits and Medical Eligibility (Division) has developed a corrective action plan to address internal control weaknesses in its TANF and food stamp benefit issuance processes and implement recommendations made by the Department's internal auditor. In response to these issues, the Auditor General will review the Division's efforts to improve system controls during the fiscal year 2003 state-wide single audit.

**Division welfare-related employee fraud cases identified**—During fiscal year 2003, the Department identified and investigated welfare-related employee fraud cases. The cases involved division employees who allegedly circumvented internal controls and fraudulently obtained TANF and food stamp benefits for themselves and their accomplices. A review of the Department's Office of Professional Practices' case logs revealed 13 substantiated cases of employee welfare fraud in fiscal year 2003. Although the value of several cases will not be determined until prosecution is complete, the Department estimates that the value of some cases ranges from \$586 to \$57,010. The cases involved at least 15 division employees. The Attorney General's Office is preparing several of these cases for criminal prosecution.

**Division plans to take corrective action**—In response to the series of welfare-related employee fraud cases, the Department's internal auditor reviewed the Electronic Benefit Transfer (EBT) System to determine the adequacy of its internal, data security, and physical controls.<sup>1</sup> After completing the review in March 2003, the internal auditor noted security weaknesses and violations in the Division's benefits eligibility computer system and inconsistent practices in local offices regarding internal controls and EBT card inventory and issuance.

The Division has developed a corrective action plan to address the control weaknesses and plans to implement the internal auditor's recommendations. Specifically, the corrective action plan includes improving the Division's EBT policies and procedures, increasing security controls, and creating system-generated reports to monitor for unusual benefit issuance activity at the local offices.

<sup>1</sup> The EBT system is the method by which clients receive welfare benefits for the TANF and Food Stamps Programs. The Division issues each TANF and Food Stamp recipient an EBT card, which is similar to a debit card.

Auditor General is conducting a review—The Office of the Auditor General is examining the adequacy of the Division's newly implemented procedures for monitoring, identifying, and limiting employee welfare fraud. It will incorporate the results of this review, along with any recommendations, into the state-wide single audit, which was published in March 2004.





# AGENCY RESPONSE





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ARIZONA DEPARTMENT OF ECONOMIC SECURITY  
1717 W. Jefferson - P.O. Box 6123 - Phoenix, AZ 85005

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Janet Napolitano  
Governor

David A. Berns  
Director

April 14, 2004

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

Dear Ms. Davenport:

The purpose of this letter is to forward the Department of Economic Security's written responses to the revised preliminary draft report of the performance audit of the Department's welfare programs.

We appreciate the cooperation of your staff throughout the performance audit process. If you have any questions regarding the response, please contact Patrick Harrington, Assistant Director for the Division of Employment and Rehabilitation Services at (602) 542-4910, or Vince Wood, Assistant Director for the Division of Benefits and Medical Eligibility at (602) 542-3596.

Thank you for the opportunity to review the revised preliminary draft report.

Sincerely,

David A. Berns

Attachment

**Department of Economic Security  
Sunset Review Draft Report  
Response to Auditor General Recommendations**

**FINDING 1**

1. The Department should include performance measurements such as the federal work participation rate and job retention in the new RFP. The department should also assess liquidated damages for vendor deficiencies as determined by the Department.

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Department will include performance measurements and liquidated damages when the next Jobs Privatization RFP is issued*

2. The Department should ensure that staff that perform contract management functions receive training targeted toward contract compliance, performance and fiscal monitoring. The Department should identify resources that could provide help in designing and teaching these classes, and develop its curriculum.

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Department's Audit and Management Services is currently reviewing the contract monitoring function of the Jobs Program to identify areas of improvement. The specific types of monitoring staff training needed will be identified. Once this is determined, contract-monitoring staff who lack required expertise will be identified and training will be arranged. The Department anticipates beginning training contract-monitoring staff by December 31, 2004.*

3. The Department should develop a training plan so that contractors and their employees are aware of necessary policies concerning case documentation, JAS input, and other matters. The Department should monitor that such training takes place.

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. A formal training plan for the current Arizona Works Program will be developed and implemented by July 1, 2004. Training regarding policies of the Contractor will be the responsibility of the Contractor. A Department Policy/Training staff person will review and monitor the Contractor's training specific to the program to ensure appropriate interpretation of Department Policy and Procedures and that Federal and State mandates are trained in a timely fashion.*

4. The Department should develop a consolidated guide, plan, and tools for monitoring contract compliance, performance, and fiscal expenditures.

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. A copy of the Monitoring Guide was provided to the Auditor General's staff on August 28, 2003.*

5. The Department should ensure that data is secure and accurate by doing the following:

- a. Define and require minimum security standards for contractors, allowing for variation according to assessed risk;

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Department will include minimum-security standards in every RFP and contract that is issued.*

- b. Require security audits or evaluations of contractors, possibly requiring contractors to procure an independent firm to perform the audit;

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Department will include a separate requirement in the RFP and contract that the contractor procure an independent firm to perform a security audit or evaluation of the contractor.*

- c. Require contractors to formulate policies that the Department would approve, such as log access review, incident report alerts, limiting access to cases and screens as appropriate, and inventory listing;

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. For contracts pursuant to the new RFP, the Jobs Program will require contractors to formulate policies that the Department would approve to ensure they are consistent with DES security standards and policies, such as log access review, incident report alerts, limiting access to cases and screens as appropriate, and inventory listing.*

- d. Modify JAS to include the ability to maintain access logs;

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Department currently operates on the standards from the Office of Data Security within the Department for access by all external customers of the department. The Administration will modify JAS to include the ability to maintain access logs. The accessibility standards will be in compliance with Department standards.*

- e. Monitor access logs and complete Incident reports from such monitoring and require the contractor to do the same;

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Administration will monitor access logs and develops incident reports from such monitoring and require the contracts to do the same.*

- f. Require contractor employees to undergo regular security awareness training, possibly using a computer-based approach already developed by the DCSE;

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Department will include in the contract that contractor employees must complete regular security awareness training. The Department will ensure that all required security awareness training is made available to each contractor, as appropriate.*

- g. Review compliance with the security requirements after the initial contract is awarded and on an ongoing basis thereafter.

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Administration will review compliance with the security requirement after the initial contract is awarded and will monitor compliance on an ongoing basis.*

## **FINDING 2**

- 1. The Division should continue its efforts to ensure that supervisors review the required number of case files by monitoring the monthly case review reports, identifying local offices that are unable to meet the monthly quotas, and taking steps improve these offices' performance. In addition, the Division should identify local offices that have established effective procedures for conducting consistent case file reviews and share these procedures with all offices.

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Division implemented a new automated case read tracking system effective January 1, 2004. The number of case reviews completed each month is captured by the automated system from which case read reports are generated. Local Office, Region, and Central Office management monitors individual office compliance with established expectations. Steps can then be taken to improve those sites that fail to meet expectations. The reports will also make it possible for agency management to identify sites that consistently meet expectations so that effective procedures can be shared with other sites as recommended.*

- 2. The Division should continue its efforts to improve its process for communicating policy changes to local office staff, continuing its efforts to update its policy and procedures. It should also continue its efforts to identify local offices that have developed effective processes for communicating policy changes to their staff and should share these processes with all offices.

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. Effective February 23, 2004, a new process for reviewing policy and training information distributed to local offices was established. This was an effective process developed in one of the Local Offices and implemented statewide. Local Office*

*Managers are responsible for ensuring that information disseminated to staff is reviewed and discussed within one week from the date the information was issued. A signed acknowledgement by each employee ensures the policy has been received and reviewed.*

3. The Division should continue its efforts to develop a training program for local office managers. The Division should ensure that the curriculum for this program includes classes on time and employee management, report use and management, and balancing increasing caseloads with reduced staff.

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Division is currently developing a training curriculum specifically for local office managers. The training content includes the following eight components:*

- *Overview of Training*
- *Introduction of FAA Management*
- *Managing the Office Functions – Local Office Procedures*
- *Management Reports*
- *Workload Management*
- *Personnel*
- *Leadership Skills*
- *Facilities*

*This training curriculum is scheduled for a workgroup review at the end of March 2004 with the final training available for delivery in May 2004.*

### **FINDING 3**

1. The Division should continue to assess it's staffing and, as resources permit it, should continue to assign extra staff to help address the overpayment backlog.

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Division identified additional staff to assist in addressing the overpayment backlog. As a result of completing 8,284 determinations in January 2004, the number of overpayment referrals, that are greater than 45-days, has been reduced to 2, 213. The agency anticipates the completion of these referrals by March 15, 2004. An ongoing assessment of staff resources will be made to balance the eligibility determination workload and the overpayment determination workload.*

2. To standardize its process for managing overpayment referrals, the Division should continue its efforts to implement an automated system for tracking and reporting overpayment referrals and claims, including the reasons referrals are not pursued.

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. On January 20, 2004, the Division implemented the first phase of an automated overpayment tracking system. In Phase I, overpayment referrals are tracked from date of discovery through the overpayment claim date as provided for in the program federal guidelines. The second phase, scheduled for implementation on May 1, 2004, will include enhancements to system design to enhance data integrity and capture additional data elements for use in monitoring internal performance measures. In the third phase, scheduled for implementation on June 1, 2004, the production of various*



*reports needed to monitor performance measures will become available for use by management.*

3. To help the Department collect more overpayments by limiting the number of overpayment referrals that are dropped due to inaccessible case files, the Division should continue its efforts to implement an electronic document scanning system.

*The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The Department is currently reviewing options for document imaging; however, funding is not included for such a project in the current budget. The Division has modified the overpayment referral process in order to limit the number of referrals dropped due to inaccessible case files. Effective January 20, 2004, all information necessary for the processing of the overpayment determination is required by policy to be included with the overpayment referral at the time the referral is made. This will eliminate overpayment referrals dropped due to the case file being inaccessible.*

## Performance Audit Division reports issued within the last 12 months

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02-03	Department of Economic Security—Kinship Foster Care and Kinship Care Pilot Program	03-L1	Competitive Electric Metering, Meter Reading, and Billing and Collections
02-04	State Parks Board—Heritage Fund	03-01	Government Information Technology Agency—State-wide Technology Contracting Issues
02-05	Arizona Health Care Cost Containment System—Member Services Division	03-02	Registrar of Contractors
02-06	Arizona Health Care Cost Containment System—Rate Setting Processes	03-03	Water Infrastructure Finance Authority
02-07	Arizona Health Care Cost Containment System—Medical Services Contracting	03-04	State Board of Funeral Directors and Embalmers
02-08	Arizona Health Care Cost Containment System—Quality of Care	03-05	Department of Economic Security—Child Protective Services—Foster Care Placement Stability and Foster Parent Communication
02-09	Arizona Health Care Cost Containment System—Sunset Factors	03-06	Arizona Board of Appraisal
02-10	Department of Economic Security—Division of Children, Youth and Families, Child Protective Services	03-07	Arizona Board for Charter Schools
02-11	Department of Health Services—Health Start Program	03-08	Arizona Department of Commerce
02-12	HB2003 Children’s Behavioral Health Services Monies	03-09	Department of Economic Security—Division of Children, Youth and Families Child Protective Services—Caseloads and Training
02-13	Department of Health Services—Office of Long Term Care	04-L1	Letter Report—Arizona Board of Medical Examiners
		04-01	Arizona Tourism and Sport Authority

## Future Performance Audit Division reports

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Department of Health Services—HB2003 Services for Adults with Serious Mental Illness

Department of Environmental Quality—Waste Programs Division