



A REPORT  
TO THE  
ARIZONA LEGISLATURE

Performance Audit Division

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Performance Audit

# Department of Administration— Financial Services Division

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JUNE • 2005  
REPORT NO. 05-02



**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

June 13, 2005

Members of the Arizona Legislature

The Honorable Janet Napolitano, Governor

Ms. Betsey Bayless, Director  
Arizona Department of Administration

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Department of Administration—Financial Services Division. 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 Administration agrees with all of the findings and plans to implement or implement in a different manner all of the recommendations.

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

This report will be released to the public on June 14, 2005.

Sincerely,

Debbie Davenport  
Auditor General

Enclosure

# PROGRAM FACT SHEET

## Arizona Department of Administration—Financial Services Division General Accounting Office (GAO)

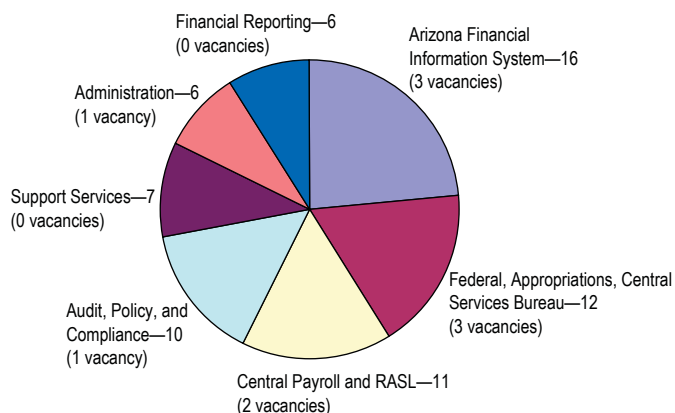
### Services:

The General Accounting Office, one of three programs within the Department of Administration's Financial Services Division, provides a variety of services and fulfills several responsibilities through the following units:

- **Central Services Bureau**—Provides a variety of budget preparation and monitoring, bookkeeping, and reporting and consulting services to small- and medium-sized state agencies on a fee-for-service basis.
- **Federal**—Negotiates and monitors federal issues affecting the State, including developing federal reporting policies and procedures, coordinating the State-wide Single Audit, and preparing the State-wide Cost Allocation Plan.
- **Appropriations**—Administers state-wide appropriation and allotment transactions, prepares and distributes the state cash basis Annual Financial Report, and approves and monitors agency revolving funds.
- **Financial Accounting**—Prepares the audited State-wide Comprehensive Annual Financial Report (CAFR) and provides technical assistance to state agencies regarding accounting issues pertaining to financial statement reporting and for the processing of fixed assets on the state-wide accounting system.
- **Audit, Policy, and Compliance**—Coordinates the development and distribution of state-wide accounting policies and procedures; maintains security for the state-wide accounting system (AFIS); and performs procedural, compliance, and special reviews of state agencies.
- **Central Payroll and State's Retiree Accumulated Sick Leave (RASL)**—Coordinates payroll for state employees, jointly administers the Human Resource Solution (HRIS) system with the Human Resource Division, and administers, reports, and accounts for the RASL program, which provides an incentive for state employees who retire from state service with 500 hours or more of accumulated sick leave.
- **Support Services**—Provides logistical and administrative support to GAO units, and signs and distributes state payments.

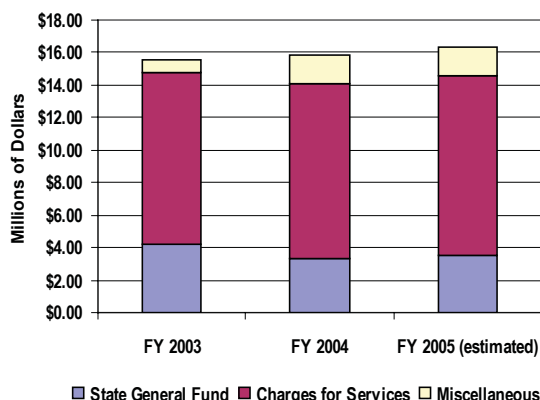
### Program staffing:

**68 positions with 10 vacancies as of March 1, 2005**



### Program revenue:

**\$16.32 million (fiscal year 2005, estimated)**



- **Arizona Financial Information System**—Maintains AFIS, including assisting state agencies in AFIS understanding and problem resolutions, coordinating AFIS enhancements, maintaining the State's vendor file, and performing various system reconciliations.

### Facilities and equipment:

GAO occupies 22,049 square feet of office space in the Department's building at 100 North 15th Avenue in Phoenix. The Department leases this building under the PLTO (private lease-to-own) program and during fiscal year 2005, was scheduled to pay approximately \$2.6 million in rent for the entire building. This amount increases annually until fiscal year 2027, when the Department is scheduled to make rent payments of \$4.46 million for this building. GAO's equipment includes typical office equipment.

### Mission:

To provide state and federal agencies, the general public, and other interested public and private entities with accurate, timely financial services, management information, technical assistance while assuring compliance with related statutes and rules; to maintain and improve the statewide automated financial systems; and to provide for the safeguarding of state assets.

### Program goals:

1. To deliver customer service second to none.
2. To attract and retain a high-performance team of employees.
3. To aggressively pursue innovative solutions and/or opportunities.

### Adequacy of goals and performance measures:

GAO has delivered a variety of performance measures that are generally in line with its goals, including output, outcome, and efficiency measures. However, it could benefit from additional goals and performance measures that would provide more information on its many activities. For example, GAO should consider establishing specific goals that reflect the numerous services it provides to state agencies and the various functions it performs. These might include goals regarding the financial and accounting services it provides to state agencies, its responsibilities for financial reporting, and its responsibilities for processing state employee payroll and state payments. Once it establishes these goals, GAO could develop additional measures, such as the number of requests its receives and fulfills for financial and accounting services, to better reflect its many activities.

Additionally, the Department should consider establishing a goal and associated performance measures to report information related to the number and types of reviews or audits of state agencies it conducts each year and whether agencies implement the recommendations made as part of these audits.

Source: Auditor General staff compilation of unaudited information obtained from the Arizona Financial Information System (AFIS) for the years ended June 30, 2003 and 2004; Master List of State Government Programs; and other information provided by the Department, including financial estimates for the year ending June 30, 2005.

# PROGRAM FACT SHEET

## Arizona Department of Administration—Financial Services Division Enterprise Procurement Services

### Services:

Enterprise Procurement Services (EPS) was created in January 2005 as a new program within the Department of Administration's Financial Services Division. In addition to providing several new functions, EPS performs the functions previously provided by the State Procurement Office. These various functions are performed through the following units:

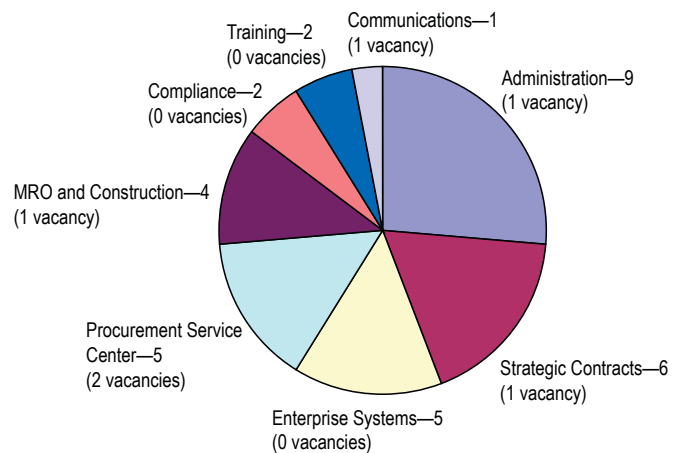
- **Communications**—Coordinates communications on procurement contracts and status, procurement policies and best practices, emerging issues, public information, and other data to procurement officers, customers, political subdivisions, and citizens.
- **Compliance**—Conducts delegation reviews and oversight of procurement authority delegated to state agencies, conducts agency procurement performance reviews, identifies and educates state agencies regarding procurement best practices, and prepares policies and procedures.
- **Enterprise Systems**—Works with state agencies and political subdivisions to provide access to the EPS Web site and automated procurement systems.
- **MRO and Construction**—Coordinates and conducts strategic sourcing for building maintenance, repair, and operations (MRO); contracts in coordination with state agencies; and contracts for building construction contracting services.
- **Procurement Service Center**—Conducts strategic sourcing and procurement functions for agencies not designated as strategic contracting centers.
- **Strategic Contracts**—Provides centralized procurement services for specific state-wide contracts such as office supplies, furniture, and information technology.
- **Training**—Provides procurement training and oversight of professional certification programs, and provides procurement standards to enable political subdivisions to award and administer state-wide contracts.

### Facilities and equipment:

Enterprise Procurement Services occupies 8,914 square feet of office space in the Department's building at 100 North 15th Avenue in Phoenix. The Department leases this build-

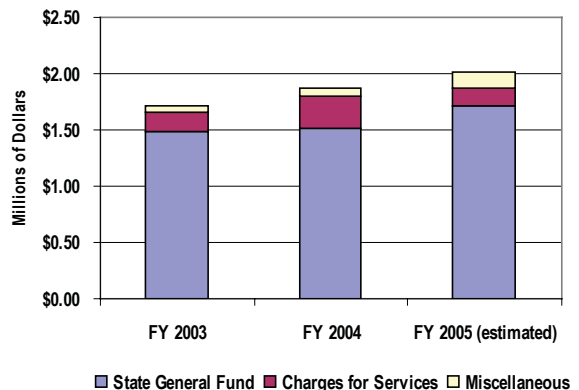
### Program staffing:

**34 positions with 6 vacancies as of March 1, 2005**



### Program revenue:

**\$2.02 million (fiscal year 2005, estimated)**



ing under the PLTO (private lease-to-own) program and during fiscal year 2005 was scheduled to pay approximately \$2.6 million in rent for the entire building. This amount increases annually until fiscal year 2027, when the Department is scheduled to make rent payments of \$4.46 million for this building. Enterprise Procurement Service's equipment includes typical office equipment.

### Mission:

One procurement community, consistently seeking best value procurement solutions for customers through innovation.

### Program goals:

1. To deliver customer service second to none.
2. To aggressively pursue innovative solutions and/or opportunities.

### Adequacy of goals and performance measures:

The following discussion of performance measures pertains to the measures that were used by the State Procurement Office (SPO). At the time of this audit, EPS had not revised or expanded these performance measures. SPO's performance measures included measures that reflect the timeliness of procurement services and customer (state agency management) satisfaction with the procurement services provided by its staff. However, EPS could develop a more comprehensive set of measures of its activities by adding input and output measures, such as the number of agency-specific procurements conducted and the number of state-wide procurements awarded by EPS staff.

Additionally, as EPS broadens its policy and oversight role, it should develop measures to reflect these activities. For example, it might report the number of policies and/or procedures issued, the number of agency reviews conducted, the outcomes of these reviews, and whether state agencies implement the recommendations made as part of these reviews. Further, when EPS determines and implements mechanisms to capture and report data on state-wide procurement activity, it should develop performance measures to report such data. For example, it could develop measures to report the annual number and estimated dollar volume of contract awards, the dollars spent under contract, the percentage of total procurements awarded by strategic contracting centers, and other measures reflecting the procurement activity and outcomes for the State as a whole.

Source: Auditor General staff compilation of unaudited information obtained from the Arizona Financial Information System (AFIS) for the years ended June 30, 2003 and 2004; Master List of State Government Programs; and other information provided by the Department, including financial estimates for the year ending June 30, 2005.

# PROGRAM FACT SHEET

**Arizona Department of Administration—Financial Services Division**  
Risk Management

## Services:

Risk Management, one of three programs within the Department of Administration's Financial Services Division, provides a variety of services and fulfills several responsibilities through the following units:

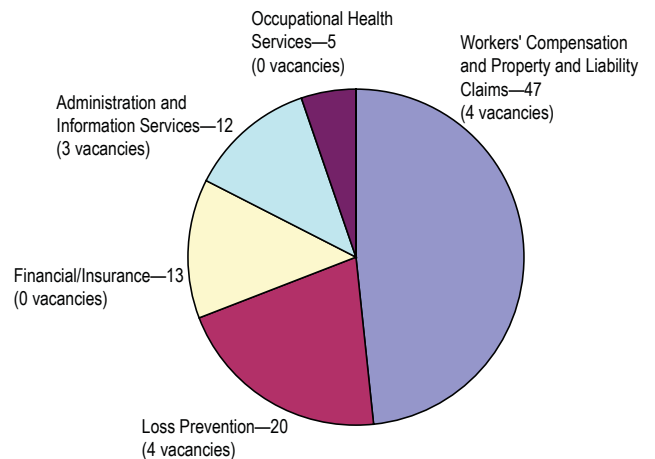
- **Workers' Compensation**—Processes workers' compensation claims on behalf of state employees injured in the course and scope of their employment and determines wage, medical, surgical, and hospital disability benefits as provided by law under the Arizona Workers' Compensation Act.
- **Property and Liability Claims**—Investigates, evaluates, negotiates, and settles claims against the State, including third-party general liability, third-party auto liability, personal injury, third-party bodily injury, and property claims.
- **Loss Prevention**—Works with state agencies to reduce or eliminate their exposure to risk by providing advice and assistance in a variety of areas, including property, liability, environmental, and worker protections.
- **Finance/Insurance**—Provides financial and accounting services, purchases excess and catastrophic insurance to supplement state-funded self-insurance, calculates state agency insurance charges, and provides agency support and customer service related to insurance matters.
- **Occupational Health Services**—Provides physical examinations to potential state employees after an offer of employment has been extended, including scheduling, evaluating, and paying for these examinations for various state agencies.

## Facilities and equipment:

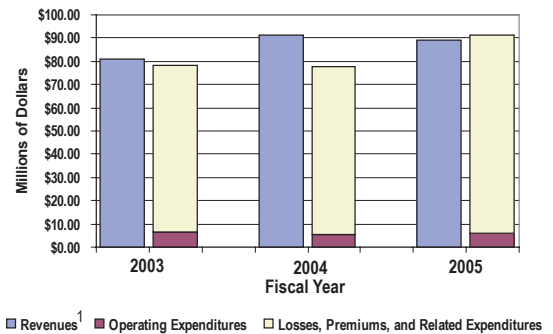
Risk Management occupies 15,048 square feet of office space in the Department's building at 100 North 15th Avenue in Phoenix. The Department leases this building under the PLTO (private lease-to-own) program and during

## Program staffing:

**97 positions with 11 vacancies as of March 1, 2005**



## Program revenues, expenditures, losses, and premiums:



<sup>1</sup> Consists of insurance charges assessed to state agencies.

<sup>2</sup> Consists of property claims, settlements, payments to workers' compensation beneficiaries, and related legal and other costs.



fiscal year 2005, was scheduled to pay approximately \$2.6 million in rent for the entire building. This amount increases annually until fiscal year 2027, when the Department is scheduled to make rent payments of \$4.46 million for this building. Risk Management's equipment includes typical office equipment.

### Mission:

To provide timely, high-quality, and cost-effective services to agency customers and the public for the State's property and liability exposures, and to our state employee customers who have work-related injuries.

### Program goals:

1. To deliver customer service second to none.
2. To aggressively pursue innovative solutions and/or opportunities.

### Adequacy of goals and performance measures:

Risk Management has developed performance measures that are generally in line with its goals, and include input, outcome, efficiency, and quality measures. However, Risk Management could benefit from additional goals and performance measures that would provide more information on its activities. For example, while it does have some measures that report on activities related to property and liability, and workers' compensation claims, it has not established any measures to reflect its handling of these claims, such as the ratio of open-to-closed property and liability and workers' compensation claims, whether these claims are approved or denied, whether these claims are processed in a timely manner, and the percentage of claims with attorney involvement.

Likewise, Risk Management does not have a goal or performance measures regarding its work with agencies on loss prevention activities. A loss prevention goal and associated performance measures might focus on the number of new programs implemented to limit the State's future liability and the number of state agency consultations performed. Establishing a broader array of goals and performance measures would better reflect the variety of functions that Risk Management performs and better inform stakeholders, including the Legislature, of these activities and their outcomes.

Source: Auditor General staff compilation of unaudited information obtained from the Arizona Financial Information System (AFIS) for the years ended June 30, 2003 and 2004; Master List of State Government Programs; and other information provided by the Department, including financial estimates for the year ending June 30, 2005.

# SUMMARY

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The Office of the Auditor General has conducted a performance audit and sunset review of the Arizona Department of Administration, Financial Services Division pursuant to a November 20, 2002, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq and is the first in a series of four reports on the Department of Administration (Department). This report focused on the development and implementation of the Human Resources Information Solution (HRIS), the State's new human resources system; procurement; and the workers' compensation claims process. The second report will focus on functions performed by the Human Resources Division, and the third report will focus on functions performed by the Information Technology Services Division. The final report will be an analysis of the 12 statutory sunset factors.

The Financial Services Division (Division) provides a variety of services to state agencies, including developing state-wide accounting policies and procedures; providing bookkeeping, reporting, and consulting services; preparing financial reports and performing internal audits; conducting state-wide and individual agency procurements; providing insurance coverage to state agencies and employees for property, liability, and workers' compensation losses; and settling property and liability claims against the State. Additionally, the Division has assisted in the development and implementation of a new state payroll and human resource system.

## DOA needs comprehensive plan to ensure completion of HRIS system (see pages 9 through 19)

The Department should develop a plan for completing the Human Resources Information Solution (HRIS) system and ensure adequate user participation in the plan's development and the system's completion. HRIS is replacing the State's Human Resources Management System, Benefits Information Tracking System, and other applications with a single integrated system to administer payroll, personnel, employee benefits, and other related functions. Phase 1 of the system was

implemented in December 2003. This phase of the system processes state employee payroll and tracks and processes various employee-related actions, such as hires, transfers, and promotions. Phase 2 functions of the system, which were in various stages of implementation as of April 2005, are expected to provide the major benefits of this new system. These functions include a hiring gateway, which assists in the hiring approval and candidate screening process, and an employee/manager self-service component, which would allow a state employee to input his/her own information, such as an address change, into the system. According to department estimates, HRIS should produce more than \$100 million in cost savings over the next 10 years by automating functions previously performed by administrative staff and reducing turnover due to increased employee satisfaction.

The Department did not meet the system's original and some of its revised implementation dates and has exhausted most of the project budget. Specifically:

- **Implementation time frames missed**—According to the initial contract awarded to the system vendor, the entire system was to be completed in 18 months. The Department expected to implement Phase 1 by April 2003 and Phase 2 by July 2003. However, amendments to the contract revised these dates. The implementation of Phase 1 was rescheduled for July 2003, and then to December 2003. Phase 2 implementation was rescheduled for May 2004. While Phase 1 was implemented in December 2003, as of April 2005, Phase 2 components were in various stages of development and implementation. These delays have occurred because of the extensive modifications needed to adapt the system's primary software to the unique business practices of each state agency and the limited funding available for continuing work on the system.
- **Project budget mostly exhausted**—The Department received approximately \$42.5 million in project funding. The Legislature appropriated \$7.5 million from the Personnel Division Fund, and the Department issued certificates of participation for the remaining funding.<sup>1</sup> This funding was originally intended to pay for the entire system. However, as of June 30, 2004, the Department reported that the project had consumed almost all of this funding.<sup>2</sup> The personnel costs for the continued development and implementation of HRIS, as well as its operations, are now funded out of the Department's Human Resources Division budget at approximately \$2 million for fiscal year 2005. While the Department has not determined the amount of additional monies needed to complete Phase 2 of HRIS and address any needed user requirements, according to a department official, ongoing development and maintenance of the system will continue as monies are made available from the Human Resources Division budget.

<sup>1</sup> Certificates of participation function similarly to a lease-purchase agreement, in that these securities are backed by the assets funded by the certificate proceeds, and nonpayment of the lease payments can result in the State's returning possession of the assets to the trustee.

<sup>2</sup> According to the Department, over \$2.3 million remains from the certificates of participation funding and has been reserved to pay for a planned upgrade to the HRIS system in fiscal year 2006 or 2007.

According to interviews with several state agency users, Phase 1 of the HRIS system does not provide all of the functionality they required or expected. The new features in Phase 2, which are expected to provide the major benefits to users, have yet to be fully implemented. As a result, some agencies report relying on in-house systems or manual processes to ensure that they have the necessary personnel information and processing capabilities. Although expected during a major system implementation, the Department has also been slow to address some of the user requests for Phase 1 modifications, some of which are needed to correct programs that do not function properly.

The Department should develop a plan for completing the system. This plan should specify the remaining functions to be implemented, identify the project budget and funding sources, outline the staff resources needed, and establish a timeline to fully implement the system. The plan should also address user requirements and requests for system changes. In January 2005, the Department began a strategic planning effort to address the future direction of HRIS. While the effort includes determining organizational capabilities and identifying the remaining work needed to complete HRIS, a comprehensive plan is still needed.

Additionally, the Department should enhance user participation on the project. Literature on information technology project development strongly recommends user involvement in *all* phases and at *all* levels of system development. While the Department has included users in several facets of the project, it should also ensure that users have input or are involved in overall project policy and direction, evaluating and prioritizing requests for system functions or changes, and at all levels of system design and system testing and acceptance.

## Planned changes should improve procurement oversight, but more can be done (see pages 21 through 29)

The Department's planned changes to state procurement practices provide a good foundation for improving oversight, but they can be further enhanced. Although department officials estimate that the State spends billions annually in state, federal, and other monies on the purchase of goods and services, the Department performs little oversight of state agency procurement activities. The Department's State Procurement Office (SPO) primarily functioned as a state-wide contracting center, conducting procurement of state-wide goods and services, and agency-specific procurement for smaller state agencies.<sup>1</sup> However, many of the State's large agencies conduct procurement under authority delegated by the Department.<sup>2</sup>

<sup>1</sup> In January 2005, the Department created a new program, Enterprise Procurement Services, which, in addition to several new functions, performs the activities formerly performed by the State Procurement Office.

<sup>2</sup> Statute designates the department director as the central procurement officer for the State, responsible for procuring or supervising the procurement of all materials, services, and construction needed by the State. Statute also authorizes the department director to delegate procurement authority to state agencies.

Several of these agencies have received little or no oversight because they have had unlimited delegated authority since the current procurement code was adopted in 1985. Fourteen state agencies have this unlimited authority and can enter into multi-million dollar contracts without outside review or approval.

The changes underway include the following:

- **State's procurement approach changing**—In response to a Governor's Efficiency Review team recommendation, the Department is making significant changes to the way the State conducts its procurements. Instead of many individual agencies contracting for the same goods or services—such as janitorial supplies or financial services—one state agency will serve as the strategic procurement and contracting center for a specific good or service. All state agencies needing this good or service will then rely on the contract. For example, the Arizona Department of Transportation (ADOT) will serve as the contracting center for automotive parts, and agencies needing these parts will use the contract developed by ADOT. The State should then benefit from the discounts that result from higher-volume purchases.

This new approach to procurement should also improve oversight. Because the number of contracts used by multiple state agencies will increase, the procurement process will be more visible, which can help ensure that procurement and contracting best practices are used.

- **New oversight unit established**—In conjunction with this effort, the Department has reorganized its procurement organization. In January 2005, the Department established the Enterprise Procurement Services program that includes a new oversight group. This group plans to issue a policy and procedure manual to guide procurement activities and conduct regular reviews of the procurement practices of agencies with high levels of delegated procurement authority. There are several opportunities to enhance these efforts beyond what is currently planned. These include expanding the proposed policy and procedure manual to include polices for administering contracts once they are in place, developing ways to gather and analyze state contracting data, and annually reviewing a random sample of individual procurements.

## Department can improve its workers' compensation claims process (see pages 31 through 38)

The Department can improve its workers' compensation claims process to help ensure that state employees who are injured while at work promptly receive benefits. The State provides workers' compensation coverage through self-insurance, and the Department's workers' compensation unit in Risk Management administers the

claims. Claims are administered according to rules and regulations established by the Industrial Commission of Arizona (Commission). For example, Risk Management must accept or deny all claims within 21 days after the Commission notifies it of a claim. According to statute, injured state employees are responsible for filing a claim with the Commission. However, injured employees often inform Risk Management of the injury before they file a claim with the Commission, and Risk Management does not have to wait for formal notification from the Commission to begin processing a claim.

While Risk Management meets the 21-day requirement for processing claims, since some claims are not promptly filed with the Commission, it may take much longer—weeks or even months—for the injured employee to know if the claim has been approved or denied. Although responsible for filing a claim with the Commission, state employees may be unaware of this requirement, or some may rely on their physicians to file an injury report with the Commission. Auditors reviewed a random sample of 43 workers' compensation claims submitted to Risk Management during fiscal year 2004 and determined that the Commission formally notified Risk Management of 35 of these claims. Risk Management approved or denied each claim within 21 days of notification.<sup>1</sup> However, Risk Management was aware of all 35 claims prior to receiving formal notification and for 17 of these claims, was aware of the injury and potential for a claim more than 3 weeks prior to the Commission's formal notification. While Risk Management actually reviewed and approved 6 of these 17 claims prior to receiving notification from the Commission, it took between 32 and 145 days for Risk Management to either approve or deny the other 11 claims from the date they were initially made aware of the injury.

Risk management can prevent unnecessary benefit delays by improving communication with injured employees. For example, although Risk Management has established an automated phone system and Web site to facilitate the reporting of work-related injuries to state employees, neither the phone system nor Web site adequately explains how to proceed with a claim or the need to report claims to the Commission. Adding this information could help injured employees receive benefits sooner.

Enhanced policies and procedures would also help Risk Management process claims more quickly. While Risk Management adopted policies and procedures for its workers' compensation claims process in April 2005, it should establish additional procedures to promptly identify injured employees who have missed more than 7 work days and explore options for obtaining needed information on injured employees from state agencies in a timely manner. Risk Management should also monitor its recently revised supervisory review procedures to ensure claims are reviewed as scheduled.

<sup>1</sup> Risk Management processed an additional eight claims without receiving commission notification.

## Other Pertinent Information (see pages 39 through 41)

As part of the audit, auditors gathered information regarding the certificates of participation (certificates) that the State issued to help fund the development and implementation of HRIS. In April 2002, the State, through the Department, issued \$63.27 million in certificates to finance a portion of the construction costs for the new state health laboratory and to help fund HRIS. The certificates function similarly to a lease-purchase agreement, in that these securities are backed by the assets funded by the certificate proceeds and nonpayment of the debt can result in the State returning possession of the assets to the trustee.

The sale of these certificates generated over \$65.7 million. The HRIS project received approximately \$35 million of this amount, and the state health lab received the remaining monies. The debt service schedule, which requires the Department to pay \$45.84 million over 11 years for the HRIS portion of the certificates, requires increasing payments annually. State agency charges for personnel administration services have been designated to service this debt.<sup>1</sup> However, beginning in fiscal year 2005, the Department shows a Human Resources Division budget deficit of \$180,000 and this deficit continues as the payment amounts increase. As a result, in its fiscal year 2006 budget submission, the Department has requested an increase in state agency charges for personnel administration services from 1.04 to 1.08 percent.

<sup>1</sup> Only state agencies covered by the State's personnel merit system, which requires these agencies to adhere to state personnel rules and regulations, are assessed this charge.

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concluded ♦

# INTRODUCTION & BACKGROUND

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The Office of the Auditor General has conducted a performance audit and sunset review of the Arizona Department of Administration, Financial Services Division pursuant to a November 20, 2002, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq and is the first in a series of four reports on the Department of Administration (Department). This report focused on the development and implementation of the Human Resources Information Solution (HRIS), the State's new human resources system; procurement; and the workers' compensation claims process. The second report will focus on functions performed by the Human Resources Division, and the third report will focus on functions performed by the Information Technology Services Division. The final report will be an analysis of the 12 statutory sunset factors.

## Financial Services Division

The Department was formed in 1972 and consists of seven divisions, including the Financial Services Division (Division). The Division's mission is "to provide effective and efficient support services to enable government agencies, state employees and the public to achieve their goal." To help fulfill its mission, as of March 1, 2005, the Division reported a total of 199 positions, with 27 vacancies. These staff provide a variety of services to state agencies through three programs described below. Additionally, the Division has assisted in the development and implementation of the State's new human resources system.

- **General Accounting Office (68 positions; 10 vacancies)**—The General Accounting Office (GAO) provides financial information to state and federal government agencies, financial institutions, and other interested public or private entities. Specifically, GAO operates the state-wide accounting system (AFIS) and the state-wide payroll portion of the Human Resources Information Solution (HRIS). GAO also provides state-wide accounting policies and procedures to state agencies; distributes and reconciles all state warrants; provides a variety of data input, bookkeeping, reporting, and consulting services

to state agencies; prepares financial reports; performs internal audits, reviews, and investigations of state agencies; and provides various types of technical assistance on government accounting and financial matters.

#### GAO Mission:

To provide state and federal agencies, the general public, and other interested public and private entities with accurate, timely financial services, management information, technical assistance while assuring compliance with related statutes and rules; to maintain and improve the statewide automated financial systems; and to provide for the safeguarding of state assets.

- **Enterprise Procurement Services (34 positions; 6 vacancies)**—Enterprise Procurement Services (EPS) was created in January 2005 as a new program within the Division. EPS replaces the State Procurement Office (SPO) as the central procurement authority for the State. EPS conducts strategic state-wide contracting for specific goods and services, conducts procurements for individual agencies when the value of the procurement exceeds the agency's delegated procurement authority or upon request, establishes and administers procurement policies and procedures, establishes standards and manages procurement authority delegated to agencies, disseminates procurement information to customers, and administers bid protests and claims appeals.<sup>1</sup> According to procurement system reports, as of December 2004, SPO staff served as the primary procurement administrators for 142 state agency-specific procurements and 139 state-wide procurements.

#### EPS Mission:

One procurement community, consistently seeking best value procurement solutions for customers through innovation.

- **Risk Management (97 positions; 11 vacancies)**—Risk Management manages the property, liability, and workers' compensation claims and losses for the State. Specifically, Risk Management provides insurance coverage to state agencies and employees for property, liability, and workers' compensation losses through self-insurance and purchased insurance policies; investigates, mitigates, and settles all property and liability claims against the State; recovers monies from third parties who have injured the State; and assists agencies in the development and administration of loss prevention programs. Also, Risk

<sup>1</sup> Statute designates the department director as the central procurement officer for the State, responsible for procuring or supervising the procurement of all materials, services, and construction needed by the State. Statute also authorizes the department director to delegate procurement authority to state agencies.

Management self-insures and self-administers the State's workers' compensation benefits for injured state employees; assists agencies in administering return-to-work programs; and recovers monies from third parties who have injured state employees.

**Risk Management Mission:**

To provide timely, high quality, and cost effective services to agency customers and the public for the state's property and liability exposures, and to our state employee customers who have work-related injuries.

## HRIS project

Starting in 1999, the Department, with the assistance of several state agencies, began work on identifying, designing, and implementing a new state human resources information system. The Human Resources Information Solution (HRIS) is replacing the State's Human Resources Management System (HRMS), Benefits Information Tracking System, and other applications with a single integrated system shared by state agencies. According to the Department, HRMS had become obsolete as key software components would no longer be supported by the vendor and the system did not capture important personnel information for management purposes. When fully implemented, HRIS should provide a single system for the administration of payroll, personnel, employee benefits, and other related functions. The Legislature appropriated a total of \$7.5 million in fiscal years 2002 and 2003 to help fund the project. The State obtained additional funding of approximately \$35 million for system development and implementation by issuing certificates of participation (see Other Pertinent Information, pages 39 through 41, for further information). The HRIS system has been implemented in two phases, with ongoing development currently occurring for Phase 2 system functions. Phase 1, which processes state employee payroll, was implemented in December 2003 (see Finding 1, pages 9 through 19, for more information on the development and implementation of HRIS).

The Department is developing a new state human resources information system.

## 1995 report and followup

As part of this audit, some concerns identified in the Auditor General's 1995 performance audit report (Report No. 95-11) were reviewed. This review revealed the following:

- **Improved handling of property and liability claims**—The 1995 report recommended that Risk Management improve the handling of property and liability claims. Specific recommendations included regular supervision of

claims adjusters, revising caseload standards, addressing internal control weaknesses, and better monitoring of contracted claims adjusters. Based on auditors' review of a sample of 16 property and liability claims submitted from July 2003 through August 2004, it appears that Risk Management has improved its processing of these claims. Specifically, auditors found that the policies and procedures for processing property and liability claims are appropriate and that the claims auditors reviewed were processed according to these policies and procedures. For example, Risk Management appropriately conducted and documented the claim investigation, documented required supervisory review and approval of claims, and appropriately assigned and monitored tasks given to contracted adjusters.

- **Stronger incentives to control losses have been implemented**—As recommended in the 1995 report, Risk Management changed its allocation model to encourage loss control behavior among state agencies. The previous model used by Risk Management to allocate insurance charges to state agencies did not provide financial incentives to encourage loss control

behaviors. However, the new model adopted by Risk Management is driven by an agency's historical loss trends and its exposure as it relates to a specific line of insurance coverage. Currently, either through self-insurance or purchased insurance policies, the State has various lines of insurance coverage, including environmental liability, medical and general liability, and auto liability. For example, based on the new allocation model, an agency's insurance charge for auto liability insurance coverage is based on the number of vehicles that an agency owns and its auto accident history. For this line of insurance coverage, the exposure to accidents is increased with a greater number of vehicles. Additionally, depending on the specific line of insurance coverage, the allocation model considers from 2 to 5 years of agency loss

history. Table 1 illustrates the revenues generated from state agency charges for insurance coverage and insurance coverage expenditures for fiscal years 2001 through 2004.

**Table 1:** Risk Management Fund Cash Balance, in Millions For the Years Ended June 30, 2001 through 2004

	2001	2002	2003	2004
Cash receipts	\$61.3	\$77.4	\$79.5	\$92.1
Cash distributions <sup>1</sup>	74.5	76.7	90.1	78.2
Subtotal	<u>(\$13.2)</u>	<u>\$ 0.7</u>	<u>(\$10.6)</u>	<u>\$13.9</u>
Beginning cash balance	<u>\$41.5</u>	<u>\$28.3</u>	<u>\$29.0</u>	<u>\$18.4</u>
Ending cash balance	<u>\$28.3</u>	<u>\$29.0</u>	<u>\$18.4</u>	<u>\$32.3</u>

<sup>1</sup> The 2001 amount includes the Legislature's transfer of \$12 million to the State General Fund.

Source: Auditor General staff analysis of the Risk Management Fund Allocation of Cash Balance schedule for fiscal years 2001 through 2004.

## Financial Services Division's operating budget

While the Division's operating budget consists of monies appropriated from the State General Fund, the majority of its revenues consist of charges assessed to state agencies for the various services it provides. Table 2 (see page 5) illustrates the Division's actual revenues and expenditures for fiscal years 2003 and 2004 and its

**Table 2:** Schedule of Receipts and Disbursements by Program, in Thousands  
Years Ended or Ending June 30, 2003 through 2005  
(Unaudited)

	Enterprise Procurement Services <sup>1</sup>		General Accounting Office		Risk Management		
	2003 (Actual)	2004 (Actual)	2003 (Actual)	2004 (Actual)	2003 (Actual)	2004 (Actual)	2005 (Estimated)
Revenues:							
State General Fund	\$1,485	\$1,511	\$ 4,219	\$ 3,361	\$80,935	\$91,350	\$89,342
Charges for services <sup>2</sup>	168	288	10,582	10,747			
Miscellaneous	68	71	763	1,739			
Total revenues	<u>1,721</u>	<u>1,870</u>	<u>15,564</u>	<u>15,847</u>	<u>80,935</u>	<u>91,350</u>	<u>89,342</u>
Expenditures and transfers:							
Operating:							
Personal services and employee related	1,457	1,284	2,663	2,726	4,217	4,409	4,725
Professional and outside services	129	19	2	2	95	74	100
Travel, equipment, and other operating	174	680	2,360	1,680	2,282	1,109	1,133
Allocated costs	23	14	17		62	68	82
Total operating expenditures	<u>1,783</u>	<u>1,997</u>	<u>5,025</u>	<u>4,408</u>	<u>6,656</u>	<u>5,660</u>	<u>6,040</u>
Losses, premiums, and related expenditures <sup>3</sup>					71,484	71,826	77,380
Retirement accumulated sick leave <sup>4</sup>							
Total expenditures	<u>1,783</u>	<u>1,997</u>	<u>11,064</u>	<u>9,128</u>	<u>78,140</u>	<u>77,486</u>	<u>83,420</u>
Net operating transfers out <sup>5</sup>					12,002	565	2,239
Total expenditures and operating transfers	<u>1,783</u>	<u>1,997</u>	<u>16,089</u>	<u>13,536</u>	<u>90,142</u>	<u>78,051</u>	<u>85,659</u>
Excess (Deficiency) of revenues over expenditures and operating transfers	<u>\$ (62)</u>	<u>\$ (127)</u>	<u>\$ (525)</u>	<u>\$ 2,311</u>	<u>\$ (9,207)</u>	<u>\$ 13,299</u>	<u>\$ 3,683</u>

<sup>1</sup> The 2003 and 2004 amounts represent the financial activity of the State Procurement Office. Beginning January 2005, the Department created the Enterprise Procurement Services program, which replaced the State Procurement Office. Consequently, the 2005 amounts include 6 months of financial activity for the State Procurement Office and 6 months of estimated financial activity under the new organizational structure. See Introduction and Background, page 2, for additional information on the new program.

<sup>2</sup> General Accounting Office amounts include a pro rata charge on other agencies' payroll expenditures for the retiree accumulated sick leave program. Risk Management amounts are charges to state agencies for insurance.

<sup>3</sup> Consists of insurance premiums, property claims, settlements, payments to workers' compensation beneficiaries, and related legal and other costs.

<sup>4</sup> Consists of payment for accumulated sick leave and associated employee-related expenditures in accordance with A.R.S. §38-615 and administration costs of the program.

<sup>5</sup> 2003 amount includes \$12 million transferred to the State General Fund in accordance with Laws 2003, First Special Session, Chapter 1.

Source: Auditor General staff analysis of financial information provided by the Department of Administration from its Arizona Financial Information System for the years ended June 30, 2003 and 2004; and department-prepared estimates for the year ending June 30, 2005.

estimated revenues and expenditures for fiscal year 2005. The Division received nearly \$109.1 million in revenues in fiscal year 2004, over \$4.87 million of which consisted of General Fund appropriations. The Division's revenues are expected to decrease slightly in fiscal year 2005, as they are estimated to be nearly \$107.7 million. The Division's fiscal year 2004 expenditures were approximately \$93 million, which represented over a 3 percent decrease from its fiscal year 2003 expenditures of approximately \$96 million. However, based on fiscal year 2005 estimates, expenditures will increase to \$109 million. According to a department official, the Department conservatively estimated fiscal year 2005 expenditures, particularly for Risk Management, and the Department does not anticipate that actual expenditures will exceed revenue in fiscal year 2005.

The Legislature also appropriates monies for Risk Management operations. These monies are appropriated from the Risk Management Fund, which consists of allocations charged to other state agencies. The allocations charged by the Risk Management program not only cover the costs of its employees and operations, but also pay for insurance premiums, property claims, liability claims/settlements, payments to workers' compensation beneficiaries, medical costs, legal costs, and other loss adjustment expenses. As previously mentioned, the allocation to each state agency is based on the line of insurance coverage, the agency's loss history, and risk exposure. As shown in Table 2 (see page 5), the Department collected \$91.35 million in agency insurance charges for fiscal year 2004 and is expected to collect an estimated \$89.34 million in fiscal year 2005. Risk Management's fiscal year 2004 expenditures were nearly \$77.5 million and are estimated to increase to \$83.4 million in fiscal year 2005.

## Audit scope and methodology

This audit focused on the Department's development and implementation of HRIS, oversight of procurement activities, and its workers' compensation claims process. This report presents findings and recommendations in the following areas:

- The Department needs to develop a comprehensive plan, with appropriate user participation, to help ensure that the continued development and implementation of the Human Resources Information Solution system meets project goals and satisfies user needs.
- The Department should continue with and augment its plans to increase oversight of state agency procurement practices.

- The Department can improve its workers' compensation claims process to help ensure that state employees who are injured while at work promptly receive benefits.

In addition, this report contains an Other Pertinent Information section (see pages 39 through 41) that provides information regarding the certificates of participation that the State issued to help fund HRIS development and implementation.

Auditors used a number of methods to obtain information about the Division's programs and to study issues addressed in this report. These methods included interviewing department and division management and staff, and reviewing statutes and administrative rules, policies, and procedures, and the Department's strategic plan for fiscal years 2005 through 2009.

Auditors also used the following methods:

- To evaluate the Department's progress in developing and implementing HRIS, auditors interviewed staff of six state agencies, five agency representatives of the project's user task force, and HRIS project managers; observed help desk operations, acceptance testing, and payroll processing; and attended various work groups associated with the project, such as meetings of the Change Control Board, which evaluates system changes, and the executive committee, which oversees the project. Auditors also reviewed HRIS documents such as the project charter, the project and investment justification submitted to the Government Information Technology Agency for review and approval, status reports, and policies and procedures; the results of customer service surveys and focus groups conducted by the Department in 2003 and 2004 to assess user satisfaction with system development and implementation; and the HRIS project plan, budget, and implementation methodology. Finally, auditors reviewed literature on best practices for information technology project development.<sup>1, 2, 3</sup>
- To evaluate the need for increased oversight of state agency procurement activities, auditors reviewed the statutes, policy manuals, and related materials of the states of California, Florida, and Washington.<sup>4</sup> Auditors also interviewed procurement officials from the same three states, procurement officials within

<sup>1</sup> United States General Accountability Office. Accounting and Information Management Division. *Federal Information System Controls Audit Manual*: GAO, January 1999.

<sup>2</sup> Taylor, James. *Managing Information Technology Projects: Applying Project Management Strategies to Software, Hardware, and Integration Initiatives*. New York: American Management Association, 2004.

<sup>3</sup> Halper, Stanley D., Glenn C. Davis, P.J. O'Neil-Dunne, and Pamela R. Pfau. *Handbook of EDP Auditing*. Boston: Warren, Gorham & Lamont, 1985.

<sup>4</sup> California, Florida, and Washington were selected for review because these states similarly delegate procurement authority to various agencies and are implementing procurement improvements or reform efforts.



two Arizona state agencies, Attorney General staff, and a Governor's Efficiency Review team member. Finally, auditors reviewed Arizona's procurement code and proposed rule revisions, and reports from the Office of the Auditor General and the Department's General Accounting Office, and attended meetings and reviewed documentation from the Department's Value in Procurement project team and committees, which are reviewing and revising state procurement practices.

- To determine whether the Department can process workers' compensation claims in a more timely manner, auditors reviewed a random sample of 48 workers' compensation claims submitted during fiscal year 2004. These claims consisted of 28 time-loss claims, 10 medical-only claims, 5 long-term care claims, and 5 claims for which the unit initially denied payment, but later paid the claim. Auditors also interviewed an Arizona Industrial Commission official and Arizona State Compensation Fund staff, and reviewed a workers' compensation claims process study prepared by the Georgia State Board of Workers Compensation, documents used by the Arizona State Compensation Fund in its claims process, and the Utah workers' compensation system and Arizona State Compensation Fund Web sites.<sup>1</sup>
- To develop information on the certificates of participation that the Department issued to help fund HRIS development and implementation, auditors reviewed the April 2002 certificates of participation official statement, audit work performed by the Office of the Auditor General in 2004 regarding the certificates of participation, and the Department's fiscal year 2006 budget submission.

This audit was conducted in accordance with government auditing standards.

The Auditor General and staff express appreciation to the director and staff of the Arizona Department of Administration for their cooperation and assistance through this audit.

<sup>1</sup> Georgia State Board of Workers' Compensation: *Best Practices—Proper Claim Reporting*, July 2003.

# FINDING 1

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## DOA needs comprehensive plan to ensure completion of HRIS system

To protect the State's investment in the Human Resources Information Solution (HRIS) system, the Department needs to formulate a comprehensive plan to complete system implementation and ensure continued user participation in system-related activities. In December 2003, the Department implemented Phase 1 of HRIS to process personnel-related, payroll, and employee benefits transactions. While implementation of this phase assured the uninterrupted processing of state employee payroll, it was implemented several months after the original date projected for its completion. Many of the system's new or added features, which were perceived to be the new system's major benefits and are being implemented in Phase 2 of the project, were still not fully implemented as of April 2005. Additionally, user expectations for system functions have not been met, and some users have become dissatisfied with the system. Therefore, the Department should continue with its recent efforts to develop and implement a detailed plan for completing HRIS and continue to ensure appropriate user participation in determining project direction and setting priorities.

## Implementation delays have exhausted most funding and some users are dissatisfied

The implementation of HRIS is still not complete and it has not provided the full range of functions anticipated. While the core payroll functions have been implemented, as of April 2005, many of the system's new or added features have yet to be fully implemented. This delayed implementation consumed almost all the project funding, resulting in significantly reduced funding and staff resources to implement the remaining system functions. Additionally, some state agencies continue to use multiple, in-house systems and processes to perform payroll-related functions that HRIS does not provide.

**HRIS implemented in phases**—The goal of HRIS is to replace the State's Human Resources Management System (HRMS), Benefits Information Tracking System, and other applications with a single integrated system shared by state agencies to administer payroll, personnel, employee benefits, and other related functions. According to the Department, it was necessary to develop a new human resources system as HRMS had become obsolete. In particular, the vendor reported to the Department that it would no longer support key software components of the system and that the system did not capture important personnel information. The State contracted with IBM to help develop and implement this new system. According to the Department, HRIS provides the opportunity to streamline human resources processes, reduce costs, improve state agency manager and employee access to human resources information, and improve customer service. Table 3 (see page 11) describes the major system components and their implementation status in the project's two phases.

HRIS is able to process payroll and limited employee-related transactions.

Phase 1 of the HRIS project, implemented in December 2003, encompasses the core state employee payroll processing functions. These include maintaining time and attendance information to process payroll and tracking and processing various employee-related actions, such as hires, transfers, and promotions. Implementation of this phase has provided for the continued processing of state employee payroll.

Phase 2 focuses on many of the added or new features that were perceived to be the major benefits of a new system and were anticipated to provide monetary savings. These include the hiring gateway, data warehouse, performance management, and employee/manager self-service functions, which are defined in Table 3 (see page 11). The components of this phase are in various stages of implementation. For example, the performance management component is undergoing user acceptance testing, and the Department expects that the hiring gateway component will be fully implemented in July 2005. The Department has estimated that HRIS will save the user community in excess of \$100 million over the next 10 years. The features that the Department anticipates will provide these savings automate functions that were previously performed by administrative staff and are expected to reduce turnover due to increased employee satisfaction. For example, the employee/manager self-service component allows a state employee to input his or her own information into HRIS for a change of address or schedule training, rather than submitting a paper document to agency administration for review and data entry.

**HRIS implementation did not meet plan**—With the exception of the final revised implementation date for Phase 1, the planned HRIS implementation dates have not been met and the project budget, originally intended to pay for the development and implementation of the entire system, has been largely exhausted. Specifically:

**Table 3: Status of Human Resources Information Solution (HRIS) Component Modules  
As of April 2005**

<b>Component Module</b>	<b>Description</b>	<b>Status</b>
<b>Phase 1:</b>		
Core System Functions	Captures, tracks, and reports the following: <ul style="list-style-type: none"> <li>• Human Resources—hires, transfers, terminations, promotions, and employee data maintenance.</li> <li>• Benefits—medical, dental, and disability.</li> <li>• Payroll—calculates payroll and issues checks or payroll advices.</li> </ul>	Implemented 12/2003
<b>Other:</b>		
General Salary Adjustment	Programming required for Legislature-approved employee raises.	Implemented 7/2004
Open Enrollment	Allows state employees to input and verify their selection of employee benefits.	Implemented 8/2004
<b>Phase 2:</b>		
Performance Management	Provides a reminder that an annual performance evaluation is due and captures evaluation information on reports.	In user acceptance testing. Need to develop training, agency rollout strategy, and communication plan. Dates for fully implementing this feature have yet to be determined.
Process Flow	Provides a reminder when documents or actions are due and tracks their status.	In production for Department only. Dates for fully implementing this feature have yet to be determined.
Analytics	Compares Arizona human resource, payroll, and benefits data to Saratoga Institute data so Arizona can be compared to national averages. <sup>1</sup>	Saratoga Institute data loaded into database in November 2004. Project team analysis of function continuing. Dates for fully implementing this feature have yet to be determined.
Data Warehouse	Captures a variety of data elements that allow for analytical and statistical reporting.	In development. Dates for fully implementing this feature have yet to be determined.
Employee/Manager Self-Service	Allows managers/employees to input, update, and view their personnel data in the system.	Rollout of view-only access for the employee self-service feature expected to begin in May 2005 with complete rollout of view-only access to all employees by July 2005. Dates for fully implementing this feature have yet to be determined.
Hiring Gateway	Creates and approves personnel requisitions and allows agencies to recruit, process resumes, and hire staff via the Internet.	Phase 1 implemented in April 2005. Department expects to complete Phase 2 and fully implement this component in July 2005.

<sup>1</sup> A PricewaterhouseCoopers Service that provides a database of comparative statistics.

Source: Auditor General staff analysis of information provided by the Arizona Department of Administration.

- **Implementation time frames missed**—According to the initial contract awarded to IBM, the entire system was to be completed by July 2003. The Department and its contractors expected to implement Phase 1, which included the core payroll functions, by April 2003, 15 months after initiating the project. Phase 2, which includes the new features such as the hiring gateway and employee/manager self-service components, was to be implemented no later than July 2003, 3 months later. However, amendments to the contract revised these dates. Specifically, the implementation of Phase 1 was changed to July 2003 and then to December 2003. Phase 2 implementation was rescheduled for May 2004. While Phase 1 features were actually implemented in December 2003, as of April 2005, Phase 2 still does not have any components fully implemented.
- **Project budget mostly exhausted**—The HRIS project was primarily funded through the issuance of certificates of participation (certificates) in April 2002, which generated approximately \$35 million, and legislative appropriations totaling \$7.5 million from the Personnel Division Fund in fiscal years 2002 and 2003 (see Other Pertinent Information, pages 39 through 41, for more information on the certificates). The certificates were intended to finance the purchase, installation, consulting services, and training costs associated with the development and implementation of both phases of the system. However, as of June 30, 2004, the Department reported that the project had consumed almost all of this funding, yet Phase 2 of the system had yet to be fully developed and implemented.<sup>1</sup> For fiscal year 2005, HRIS was changed from a project with its own budget to an operating unit of DOA's Human Resources Division. The personnel costs for continued HRIS development and implementation, as well as its operations, are now funded out of this Division's budget at approximately \$2 million for fiscal year 2005. While the Department has not determined the amount of additional monies needed to complete Phase 2 of HRIS and address any needed user requirements, according to a department official, ongoing development and maintenance of the system will continue as monies are made available from the Human Resources Division budget. Additionally, according to HRIS project management, the limited funding available for continuing work on the system has partially contributed to the delays in completing the system.
- **Staffing reduced**—With the reduction in funding, staff resources devoted to implementing Phase 2 have also been significantly reduced. During the first 2 years of project development and implementation, as many as 59.5 staff positions were dedicated to the HRIS project.<sup>2</sup> However, project staffing has been reduced by approximately 70 percent. As of November 2004, 17.5 positions were dedicated to the system for continued development and

<sup>1</sup> According to the Department, over \$2.3 million remains from the certificates of participation funding and has been reserved to pay for a planned upgrade to the system in fiscal year 2006 or 2007.

<sup>2</sup> Phase 1 was implemented by a combined team of state employees, some on loan from other state agencies, and vendor employees.

implementation, as well as for system operations and maintenance. According to the Department, staffing will be further reduced to 15.5 positions by May 2005.<sup>1</sup>

The extensive modifications made to adapt the system's primary software to the unique business practices of Arizona's state agencies contributed to the delay in implementing the system. According to the contract, the primary contractor assumed that the system would be implemented using the standard, out-of-the-box software. However, this would have required state agencies to modify their diverse business practices and move to standard processes that could be supported by the software. While a department official indicated that state agencies had committed to adjusting their business practices to conform to the system, agencies did not do so. As a result, the modifications required to the system significantly extended the time needed to complete the project.

**User expectations not met**—Due to the delayed implementation of Phase 2, state agency users have not yet received many of the features they expected. These included features such as the hiring gateway, which assists in the hiring approval and candidate screening process, and the employee/manager self-service feature. Additionally, according to HRIS project management, in order to make the target date to process state payroll with the new system by year-end 2003, some of the Phase 1 user requests for particular functions were deferred. For example, users requested the ability to retain employee history, such as the length of state service and pay rates when an employee transfers to another agency. According to a department official, while this function has not been implemented, agencies can request this information from the Department. Additionally, users requested the ability to print leave balances on employee time sheets. While the Department can generate a file from HRIS with the necessary information, this file must be individually sent to agencies, and agencies desiring this capability must develop a custom program to print a time sheet in the desired format. Additionally, according to a department official, even though this feature had been available since the implementation of Phase 1, it has not been made readily available to users. In fact, only the Department and another agency use this feature, and other agencies auditors spoke with were unaware that the Department could provide this service.

Some user requests for system features have not been implemented.

In addition, while the Department has received numerous requests for system changes or fixes, which is to be expected for a major system implementation, it has been slow to address some of these user requests. According to HRIS project management, this is a result of reduced funding and staffing, the resources needed to maintain the operational stability of the system, and its focus on implementing Phase 2 and other legislatively mandated changes, such as the July 2004 salary increase for state employees. User requests include fixing programs that do not function properly or requests for additional features to provide agencies with adequate human resources system and information capabilities. For example, as of

<sup>1</sup> Three of the 17.5 FTEs spend only a portion of their time on HRIS, and 3 of the 15.5 FTEs will spend a portion of their time on HRIS only in conjunction with other duties.

October 2004, the Department was tracking 40 outstanding requests for Phase 1 program changes. This included 32 requests categorized as either critical or high priority. Three of these requests identified as critical were made in March or April 2004, while one high priority request was made in September 2003 and four other high priority requests were made in July 2004. Although HRIS project management is responding to some identified user requirements, such as the need for improved training and help desk responsiveness, user needs not yet fully addressed include the completion of Phase 2 components, difficulty in finding answers to system-related problems, and the need for better communication.

**Some users dissatisfied with system**—System data entry requirements, the delayed implementation of Phase 2 components, and the deferral or rejection of some agency requests for system functionality has led to some user dissatisfaction with the system. For example, HRIS requires agencies to capture more information within the system as compared to the previous payroll system. As a result, agencies report additional staff time spent on data entry for HRIS. Additionally, the Department reported it could not accommodate some agency-specific needs within the system framework. This included a Department of Economic Security request that the system verify fund availability before processing a time record. According to the Department, this request would have required an interface with the Arizona Financial Information System, which was not practical to pursue for a single agency given the time and resources needed to develop this capability. As a result, some state agencies have continued to operate and maintain alternative information systems and manual processes to capture and provide payroll and human resource information at their own cost. Specifically:

- **Users relying on in-house systems**—One of the major objectives of the HRIS system was to eliminate duplicate automated systems and processes. However, according to interviews with six randomly selected agency officials, four of the six users continue to use or rely on their own in-house systems because the HRIS system, as currently operating, has not eliminated that need. These systems range from simple spreadsheets to time accounting systems. For example, one agency official indicated that the agency maintains an in-house personnel database and time/activity system to meet the agency's functional needs. In fact, this agency official reported that the HRIS project manager recommended that the agency's functional needs would be better served by retaining their existing system. Another agency official indicated that they have retained an in-house labor distribution system as agency staff felt that the HRIS labor distribution feature would be too cumbersome to use. However, this official further reported that the agency is reviewing its business processes to be able to use the full functionality of HRIS. Another state agency reports using Excel software to maintain personnel data for reporting purposes as the report generation feature within HRIS is too complex to operate. Finally, at least one large state agency has indicated its intention to develop new in-house systems at its own cost if HRIS cannot provide the functions that it needs.

Some agencies continue to use in-house systems for human resources needs.

## Department needs new plan for project's completion

The Department should develop and implement a comprehensive plan for the completion of the HRIS system and ensure adequate user participation in the plan's development and the system's completion. In January 2005, the Department began a strategic planning effort with the goal of developing a new plan, and it should ensure that this plan identifies the remaining system features or user requests that remain to be implemented, and the budget, staff resources, and calendar time needed to fully implement the system. Additionally, consistent with industry best practices, the Department should continue to facilitate user participation in the project by involving users in project leadership and the establishment of plan deliverables and priorities.

**New plan needed to direct remaining project work**—To help ensure that the remaining features of the HRIS system and user requests for system features and changes are fully implemented or otherwise appropriately addressed, the Department should develop a plan to direct this effort. Prior to the project's initiation, a project plan was developed that specified the various functions to be implemented, the goals and objectives of the project, the project budget and sources of funding, the staff resources needed, and a time line for project completion. However, this plan is outdated, and the Department needs to develop a new plan for completing HRIS because development and implementation of the remaining system functions continues to languish. In November 2004, the Department provided auditors with various dates for testing, piloting, and/or implementing these functions. However, it has missed some of these dates. For example, the Department reported that the first phase of the hiring gateway was being piloted with implementation expected by January-February 2005. This date was not met and Phase 1 of the hiring gateway was implemented in April 2005. The Department expects to complete Phase 2 and fully implement this component in July 2005. Additionally, the Department has yet to determine when the data warehouse and employee/manager self-service functions will be fully implemented.

The Department has missed Phase 2 project milestones.

In January 2005, the Department began a strategic planning effort to address the future direction of HRIS and user requirements and requests for system changes. Since holding this strategic planning session in January 2005, the HRIS executive team has held additional meetings to determine its organizational capabilities, identify the remaining work needed to complete HRIS, and address customer requirements. This includes the remaining Phase 2 components and additional items needed to reflect changes in the state's personnel system or to upgrade HRIS. Additionally, the Department has developed project plans for the completion of two Phase 2 components, the hiring gateway, and employee self-service. For example, the hiring gateway plan details the various steps, such as product review, testing, and roll-out strategy and time frames that should be completed to implement this component. In addition to these efforts, the Department should develop a



comprehensive plan that brings together these various planning efforts, to direct and prioritize the remaining work needed to complete HRIS.

**User participation should be continued**—The Department should continue to include and, where necessary, enhance user participation in system development and implementation. Literature on information technology project development strongly recommends user involvement at all phases of system development. The Department has established the following project management structure for HRIS development and implementation:

- **Executive Committee**—Meets every other week to establish project policies and direction. The committee consists of department assistant directors, the Director of Arizona Government University, and the HRIS manager, and is chaired by the HRIS project manager, who is also a department assistant director.

The State's former chief information officer, in a November 2002 letter to the Department's director, criticized the lack of nondepartment members on the HRIS Board of Directors (currently the executive committee). There are still no users on the committee, and the Department has not established a documented process to obtain and consider user input regarding project policies and direction. However, according to the Department, it plans to involve users in the development of a strategic plan for completing HRIS and in helping to establish remaining project priorities.

- **Project Team**—Performs the day-to-day work to support the design and implementation of new functions or system changes and performs such tasks as computer programming, testing, and training. Team members consist of department employees and contractors. While there are no agency users on the team, the Department has established and plans to continue to establish user groups to plan for the rollout and testing of Phase 2 components. However, with the exception of the hiring gateway, the Department does not follow a documented process for soliciting user feedback on critical design issues and decisions related to the continuing development of Phase 2 components and prior to the testing and rollout of these components.
- **Change Control Board**—Generally meets weekly to evaluate and approve system change requests. The Board consists of several project team members, one of whom acts as a facilitator. Although the Board has a process to formally assess the impact of change requests and prioritize these requests, it does not follow this process, nor do users have input regarding priorities. However, as part of the strategic planning process that it began in January 2005, the Department reports that it plans to meet with customers to assess and prioritize their system needs and requirements. Additionally, the Department should follow its process for formally assessing the impact of requested system changes and for approving their implementation and priority on the list of items awaiting action.

- **User Task Force**—This group comprises users from representative state agencies that provide input and make recommendations on user-related issues to HRIS project management. Members of this group were only committed to serve from April 2004 to June 2004. While these members stayed on the task force through its September 2004 meeting, from October 2004 through December 2004, the task force did not meet because the Department reports its resources were needed to implement system modifications. However, users' willingness to continue participation on this task force had also diminished because some of its recommendations had not been implemented. For example, the task force recommended in June 2004 that improvements be made to the self-directed help process and to the project's process for reviewing and prioritizing requests for system changes or fixes. According to HRIS project management, these recommendations have not been implemented. After this period of inactivity, the Department reconstituted the task force and it began meeting again in January 2005.

Literature on information technology project development strongly recommends user involvement in system development. For example, the *United States General Accountability Office Federal Information System Controls Audit Manual* recommends active user involvement throughout the system development process.<sup>1</sup> Additionally, *Managing Information Technology Projects*, a publication of the American Management Association, states that there are several strategies for making stakeholders feel they are a part of the project.<sup>2</sup> Some of the most common strategies for satisfying stakeholder requirements and answering their concerns are actively involving them in the project, including them in project reviews, soliciting their advice, and including them in major project strategy decisions. Finally, according to the *Handbook of EDP Auditing*, "user involvement throughout the system development life cycle helps to avoid developing systems that do not meet the user's needs, are inefficient, are not adequately controlled, and are not acceptable to, or understandable by, operating level personnel."<sup>3</sup>

Consistent with best practices, the Department should enhance user participation on the HRIS project. Specifically, the Department should establish a process for soliciting, considering, and taking action on user input regarding overall project policy and direction, and follow through with its plans to involve users in the development of a comprehensive plan to complete HRIS. Additionally, the Department should establish a documented process by which the project team obtains user participation and approval at critical project phases, such as application design and acceptance testing.

The Department should enhance user participation on the project.

<sup>1</sup> United States Government Accountability Office. Accounting and Information Management Division. *Federal Information System Controls Audit Manual*. Washington, D.C.: GAO, Jan. 1999.

<sup>2</sup> Taylor, James. *Managing Information Technology Projects: Applying Project Management Strategies to Software, Hardware, and Integration Initiatives*. New York: American Management Association, 2004.

<sup>3</sup> Halper, Stanley D., Glenn C. David, P.J. O'Neil-Dunne, and Pamela R. Pfau. *Handbook of EDP Auditing*. Boston: Warren, Gorham & Lamont, 1985.

User participation needed in design and testing—Once the executive committee or change control board has approved a change or enhancement to HRIS, user participation continues to be necessary for system design and testing. User participation in system design reduces the risk that a project change will fail to accommodate the users. Although the Department involved users in the early stages of the HRIS system design and in the development of some Phase 2 features, the Department has not involved users in the design of approved changes or enhancements to the system.

User participation is also critical for system testing and acceptance. Typically, information technology projects use a testing methodology to ensure a system change or modification operates as designed. Such methodologies rely on system users to perform testing and to sign off that the application is operating properly before the change is introduced into the “live” processing environment. An independent testing/quality assurance function is standard industry practice to add independence to the process. However, the Department has recently identified some concerns with its testing methodology. For example, the Department lacks a formalized testing methodology and individual test plans, inadequately documents test results, and has dedicated insufficient resources to ensure acceptance testing processes are always followed. The Department has proposed various solutions to address these concerns. Additionally, while users participated in acceptance testing for Phase 1 of the system and the hiring gateway, users have not participated in acceptance testing related to user requests for changes or enhancements to the system. Members of the HRIS project team have performed and signed off on these test results on the users’ behalf. Therefore, the Department should ensure that it addresses the concerns with its testing methodology and that users participate in all phases and at all levels of acceptance testing.

## Recommendations

1. The Department, in collaboration with the user community, should develop a comprehensive plan to direct the completion of the HRIS system. This plan should specify the goals and objectives for completing the project, and the remaining functions to be implemented; and identify a process for addressing user requests for system features and changes, and the funding, staff resources, and time frames for completing the system's remaining functions and fully implementing the system.
2. The Department should follow its process for formally assessing the impact of requested system changes and for approving their implementation and priority on the list of items awaiting action.
3. The Department should continue to address the concerns with its acceptance testing process, including developing a testing methodology, individual test plans, and documenting test results.
4. The Department should enhance user participation in the HRIS project by:
  - a. Following through with its plans to involve users in the development of a comprehensive plan to direct the completion of HRIS;
  - b. Establishing documented processes by which the executive committee obtains, considers, and takes action on user input regarding overall project policy, and by which the project team obtains user participation and approval at critical project phases;
  - c. Including users in the process for prioritizing system changes; and
  - d. Involving users in all phases of system design and acceptance testing.



# FINDING 2

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## Planned changes should improve procurement oversight, but more can be done

The Department's planned changes to state procurement practices provide a good foundation for improving oversight, but they can be further enhanced. While Arizona spends billions of dollars annually on purchased goods and services, the Department has historically performed minimal state-wide oversight as to the quality and appropriateness of procurements. However, the Department's Value in Procurement (VIP) effort, with a focus on achieving cost savings through contracts used by multiple agencies, should increase oversight of these procurements. Additionally, the Department has reorganized its procurement functions to place greater emphasis on development of procurement policies and oversight of state agency procurement activities. In conjunction with these changes, the Department should develop policies for contract administration and study methods to capture and report basic data on state contracting activity.

### Department's procurement oversight has been insufficient

Despite the billions of dollars that the State spends annually on the purchase of goods and services, as well as a history of documented problems in procurement, the Department has performed minimal oversight of state agency procurement, and its State Procurement Office (SPO) has served mainly as a state-wide contracting center.<sup>1</sup> Specifically, while the Department

#### Procurement encompasses the following functions:

**Planning**—Includes needs assessment, research of market conditions and technological advancements, and gathering financial information for cost-benefit and other analyses.

**Solicitation**—Development and public release of a document specifying the goods or services sought.

**Evaluation and Award**—Process in which bids or proposals are rated for quality and ability to fulfill organizational needs.

**Contract Development**—Developing the written legal agreement that specifies the goods or services to be provided, price and payment provisions, and vendor delivery and performance requirements.

**Contract Administration**—Ensuring that contract terms are met by the vendor from award to close of contract.

<sup>1</sup> In January 2005, the Department created a new program, Enterprise Procurement Services, which, in addition to several new functions, performs the activities formerly performed by the State Procurement Office.

delegates its procurement authority to several state agencies, it has performed little or no oversight of these agencies' procurement practices.

**The cost of poor contracting**—A significant portion of Arizona's annual budget is spent on the procurement of goods and services. While data is not available regarding the total expenditures that the State makes through procurement, a procurement official estimated that state, federal, and other funds expended under contract exceeded \$6 billion in 2003. The State Comptroller, who reviewed this estimate, suggested that this figure appeared to be conservative. However, recent Auditor General audits revealed that poorly planned and executed procurements have occurred and may have led to significant loss or waste of taxpayer money. For example:

- A January 2003 Auditor General report found that the Government Information Technology Agency entered into a \$30.6 million dollar contract without using procedures to ensure the contract was necessary or reasonable (see Report No. 03-01). The procurement had multiple problems, including a lack of funding, planning, stakeholder input, legal review, and contract management provisions.
- A 2001 Auditor General report found that the Department of Corrections' poor planning and contract management led to a cost overrun of \$5.8 million on an information system contract, over twice the \$2.5 million budgeted (see Report No. 01-18).

**Department has performed few oversight functions**—Despite the potential costs of poor procurement practices, the Department has performed little oversight of state agency procurement activities. The Department's State Procurement Office had primarily functioned as a state-wide contracting center, conducting procurements of state-wide goods and services and agency-specific procurements. The majority of SPO staff, 15 of its 25 filled positions, performed or supported direct contracting activities. In addition to the contracting activities, SPO provided some oversight, including offering procurement training; reviewing agencies' use of sole source and emergency procurements that are not competitively bid; and reviewing agencies' procurement policies, practices, and staff credentials prior to granting increased delegation authority.

What oversight SPO provided was limited and had significant gaps. For example, statute designates the department director as the central procurement officer for the State, responsible for procuring or supervising the procurement of all materials, services, and construction needed by the State. According to statute, the department director can delegate procurement authority to state agencies. While SPO would conduct a review of an agency's procurement policies, practices, and staff credentials prior to increasing the agency's delegated authority, many of the State's largest agencies have never been reviewed. Instead, according to a SPO administrator, 12 of these agencies have had unlimited authority since the current

procurement code was adopted in 1985. As of November 2004, 20 state agencies have delegated authority of \$100,000 or more to procure goods and services (see text box).<sup>1</sup> Fourteen of these 20 agencies have unlimited authority and can enter into multi-million dollar contracts without outside review or approval.

The Department has not reviewed procurement practices of several state agencies with unlimited procurement authority.

## Procurement reforms will help improve oversight

Arizona has identified procurement as an area for government reform. Through its Value in Procurement (VIP) effort, the Department and the state agency procurement community have designed a new model for state contracting that will increase the number of multi-agency procurements. In addition to planned cost savings, this model should also increase oversight.

### New model better leverages State's purchasing

**power**—The Governor's Efficiency Review (ER) identified procurement as a major area for state-wide reform. Specifically, it identified the fact that the State could realize savings if state agencies purchased collectively, leveraging state purchasing volume to attain reduced pricing. For example, instead of many individual agencies contracting for the same goods or services, such as janitorial supplies or financial services, the ER recommended that state agencies should procure collectively, benefiting from the price discounts that would result from higher purchase volumes. In response to this recommendation, the Department and procurement officers from state agencies began the Value in Procurement effort in July 2004. The VIP team has developed a new model for state contracting in which one state agency will serve as the strategic contracting center for the procurement of a particular good or service. Other state agencies that need this good or service will then rely on the contract. The Department has estimated savings of \$29 million to \$34 million in fiscal year 2006 in state, federal, and other funds from using this procurement approach. Table 4 (see page 24) provides examples of several of the first state-wide contracts to be awarded under the new model.

### New contracting model should increase oversight

—Because the model increases the number of contracts used by multiple state agencies, it should provide increased visibility for contracts previously developed in isolation. Specifically, since the contracting agency will need to accommodate the needs of multiple agencies, state agencies will work collaboratively under the new model, overseeing one another

#### Agencies Delegated Procurement Authority of \$100,000 or Higher

##### Delegation Amount—Unlimited

Administration, Department of Arizona Health Care Cost Containment System

Commerce, Department of Corrections, Department of Economic Security, Department of Emergency and Military Affairs, Department of

Environmental Quality, Department of Game and Fish Department Health Services, Department of Juvenile Corrections, Department of Parks Board, Arizona State Public Safety, Department of School Facilities Board Transportation, Department of

##### Delegation Amount—\$250,000

Education, Department of Retirement System, Arizona State Veterans' Services, Arizona Department of

##### Delegation Amount—\$100,000

Coliseum & Exposition Center Lottery, Arizona State Revenue, Department of

The Department is implementing a new procurement model.

<sup>1</sup> Most other state agencies have delegation authority of either \$10,000 or \$35,000 and must have SPO conduct any procurements exceeding these amounts. Some state agencies are exempt from the state procurement code and department authority, including the universities and legislative agencies.



**Table 4:** Examples of Planned Procurements  
As of April 2005

<b>Strategic Contracting Center</b>	<b>Item</b>	<b>Other Agencies Using Contract</b>	<b>Estimated Award Date</b>
Department of Commerce	Grant writing services	All agencies needing the service	Complete
Department of Transportation	Automotive parts	Departments of Administration, Corrections, and Game and Fish	Complete
Arizona Health Care Cost Containment System	Physician services	Departments of Corrections, Economic Security, and Health Services	July 2005
Department of Administration	Commercial flooring	All agencies needing flooring	August 2005

Source: Auditor General staff analysis of information provided by the Arizona Department of Administration and the Value in Procurement strategic contracting center committee.

and increasing the likelihood that procurement best practices will be used. For example:

- The planning and needs assessment phase of a procurement is unlikely to be omitted since other agencies' requirements must be considered. Procurement officers auditors interviewed indicated that currently this phase of procurement may be abbreviated or dropped due to time constraints and workload pressures.
- Evaluations of contract proposals are likely to be conducted by procurement representatives of multiple agencies. Because the procurement representatives from the various agencies may scrutinize proposals more carefully to ensure their own agency requirements are met, the evaluation process may improve overall—better ensuring that proposals meet the specified requirements and provide the best value for the State.

## Reorganization will increase oversight

In addition to changing the way state agencies perform procurements the Department has reorganized its procurement organization to enhance its oversight role. Specifically, in January 2005, the Department established a new procurement program, Enterprise Procurement Services, that includes an oversight group that will issue a policy and procedure manual to guide procurement activities and conduct regular reviews of the procurement practices of agencies with high levels of

delegated procurement authority. Further, proposed administrative rule revisions will increase oversight of agency procurements.

**Department created oversight unit**—As part of the VIP planning effort, the Department formed several committees to review possible improvements to state procurement. One of these committees reviewed the role and functions of SPO and recommended its reorganization, including an increased focus on procurement oversight. In the new organization, Enterprise Procurement Services will consist of an operational group and a policy and oversight group. The operational group will conduct agency-specific procurements and serve as the strategic contracting center for several types of purchases, such as office supplies and information technology.

The oversight group will include a best practice and compliance unit that will focus on oversight of state agency procurement activities. According to department plans, this unit will have a staff of three with a manager. While these plans were not formulated in time to be reflected in the Department's fiscal year 2006 budget request, the Department has identified options to fund three of the four positions internally, with funding for the fourth position to be part of the fiscal year 2007 budget request.

The Department plans to increase oversight of state agency procurement activities.

**Plans for state-wide policy and procedure manual**—One of the responsibilities of the best practice and compliance unit will be to develop a policy and procedure manual. The Department can improve oversight and foster more consistent procurement practices among state agencies by developing an internal procedure manual for use by procurement staff state-wide. Contracting personnel in both SPO and state agencies expressed the need for such a manual. Although the State Procurement Code and the *State of Arizona Accounting Manual* detail the legal and regulatory requirements for procurement, neither provide contracting personnel with detailed instructions on how to conduct key procurement processes. For example, a procedure manual could provide guidance on whether a particular procurement requires a needs assessment and/or market research prior to solicitation. It could also provide guidance on the development of the scope of work, which is the primary description of the goods and services upon which a vendor constructs a bid or proposal. Likewise, the procedure manual should detail how to develop and document a methodology to evaluate vendor proposals and provide examples of evaluation methodologies for different types of procurements, such as human services or information technology.

The planned policy and procedure manual should provide needed guidance to state agencies.

Other states that auditors reviewed had detailed manuals of this type available through their Web sites.<sup>1</sup> For example, the State of Washington's procurement manual includes a chapter discussing best practices in key procurement processes. Further, the National Association of State Procurement Officials identifies the

<sup>1</sup> California, Florida, and Washington were selected for review because these states, similar to Arizona, delegate procurement authority to various agencies and are implementing procurement improvements or reform efforts.

publication of both a policy manual and an internal procedure manual as a responsibility of the central purchasing authority.<sup>1</sup>

**Conducting reviews of agency procurements and contracts**—The Department also plans to conduct best practice reviews of agency procurements, focusing on agencies with high and unlimited delegated authority. As of December 2004, the Department had not yet defined what these reviews would encompass, but they might examine such things as whether solicitations generated a sufficient number of qualified bidders, whether proposal evaluation criteria was appropriate and fair, and whether vendor evaluation mechanisms were established in the contract. According to the State Procurement Administrator, each of the 20 agencies with delegated authority of \$100,000 or more could undergo a review every 3 years. The administrator indicated that existing compliance reviews conducted by the Department's General Accounting Office (GAO) and the Auditor General provide an appropriate level of oversight for the other agencies.<sup>2</sup> However, these reviews focus only on legal compliance and do not consider such factors as procurement value, quality, and use of best practices. Therefore, as time and resources permit, the Department should develop a plan for conducting reviews of a random sample of procurements annually to assess these additional, important factors. This would enable the Department to review whether the procurement activities of other state agencies are following best practices as well.

**Providing public notice of noncompetitive procurements**—The Department, with the assistance of several agency procurement officers, is completing a second draft of administrative rule revisions for submission to the Governor's Regulatory Review Commission in April 2005. As part of this rule revision package, the Department has proposed a requirement that the State post planned sole-source procurements on the Enterprise Procurement Services Web site for 5 days prior to awarding a contract, making them available for public and vendor review prior to proceeding with the sole-source procurement. Sole-source procurements are those where a single vendor has been identified to provide the good or service and therefore, will not be competitively bid. However, by requiring that these planned sole-source procurements be posted on the Web site prior to award, additional vendors may be identified, which might result in a competitive procurement process. In effect, this rule revision offers the opportunity for greater oversight of sole-source procurements to help ensure they are justified and that other vendors do not exist that can potentially provide the requested good or service.

The federal government, Florida, and California require public notification of sole-source procurements. In fact, a purchasing official from California expressed the belief that agencies were less likely to conduct unjustified, noncompetitive procurements if required to publicly post the procurement.

The Department plans to require proposed sole-source procurements to be posted on its Web site prior to award.

<sup>1</sup> The National Association of State Procurement Officials. *State and Local Government Purchasing Principles and Practices*, 5th edition Lexington: The National Association of State Procurement Officials, 2001.

<sup>2</sup> Both GAO and the Auditor General conduct procedural compliance reviews of state agency procurements on a multi-year review schedule.

## Additional oversight mechanisms can benefit state procurement

In addition to its plans for improved oversight, the Department should take other steps to better oversee state-wide procurement. These steps include issuing guidelines on contract administration practices and exploring various options for capturing and using data on state-wide procurement and contracting activity.

### Policies and procedures should address contract administration—

State procurement practices lack proper emphasis on contract administration. Procurement staff and officials auditors interviewed identified contract administration as a particularly weak area in state procurement. Contract administration or management refers to the task of ensuring that contractors deliver the contracted goods and/or services within the specified time frame. For the purchase of certain commodity items, contract administration may be straightforward and may not consume significant staff hours. In contrast, the contract administration responsibility for a \$30 million information system contract may be much more complex and time consuming. However, neither the procurement code nor the few policies SPO has issued in the past provide guidance to state agencies for appropriate oversight and administration of their contracts. As a result, multi-million dollar state contracts may have few or no established procedures for contract management to help ensure that vendors satisfy the contract's terms and conditions.

The state of Florida and the federal government have various requirements for contract administration. Specifically, Florida statute requires that contracts for services have appointed contract managers. In Arizona, improved contract administration might lead to cost savings for the State. For example, in 2002 and 2003, the Department identified that the State was over-billed by more than \$2 million under its telecommunication contracts with Qwest and AT & T. While the Department reports that it has recovered these monies, inadequate contract administration—specifically, not reviewing vendor billings against contract terms and pricing—led to this problem.

Therefore, as part of its development of a state-wide policy and procedure manual, the Department should also develop appropriate policies, procedures, and/or guidelines for contract administration. In doing so, the Department should consider defining the duties of a contract administrator; developing appropriate contract language for the scope of work and deliverables to facilitate contract administration; how vendor performance should be evaluated and shared with other agencies; and a possible requirement that contracts exceeding a certain dollar amount have an appointed contract administrator, possibly depending on the complexity or dollar amount of the contract.

Greater emphasis is needed on contract administration.

**Study alternatives for compiling contracting data**—The Department lacks basic information needed to oversee and gauge improvement in state procurement activities. For example, the Department does not collect information related to how much the State spends each year under contract, the number of contracts that each state agency has entered into, the volume of transactions and dollars spent in various categories of goods and services and how this changes from year to year, the number of contracts procured competitively and noncompetitively, and the amount of state investment in procurement and contracting activities.

Although the Department's Arizona Financial Information System (AFIS) is capable of capturing the information needed to track contracting activity, the system has not been used for this purpose; consequently, agency business processes are not in place to support this use. For example, most state agencies do not have business processes in place to set up contracts on AFIS, and then tie the payments to a contract number.

Because data on contracting activity is critical to assessing and analyzing state procurement practices, the Department should study the costs and benefits of different methods to obtain data, two of which are discussed below.

- **Use AFIS to capture contract data**—While AFIS has the capability to capture contracts and link vendor payments to the appropriate contract, it may be costly for the State's large agencies, such as the Departments of Transportation and Economic Security, which only submit summary financial data to AFIS, to set up all their contracts in this system. Smaller state agencies, on the other hand, may be able to use AFIS. The Department could consider requiring those agencies with independent financial systems to report on their contracting activity, while using AFIS to capture contract data for other agencies. However, according to AFIS system administration, there would be several costs associated with implementing the contracting capabilities in AFIS, such as developing system edits and a statewide contract numbering scheme, testing AFIS contracting capabilities, and developing new software programs to extract contract activity reports.
- **Integrate purchasing system with AFIS replacement**—The Department plans to conduct a study to evaluate the State's current capabilities and long-term needs for state-wide financial computer systems. According to the State Comptroller, this study will consider a replacement for AFIS and other major agency financial computer systems. The capability to collect and report contracting data and information will also be considered. Some department officials have indicated that a new purchasing system should be a component of a new financial system, as opposed to a separate information system that would require subsequent integration with a financial/accounting system. The Department plans to study these issues during 2005 and present study results to the Legislature in fiscal year 2006.

The Department should explore options for collecting contracting data.

## Recommendations

1. The Department should continue with its plans to develop and implement a state-wide procurement policy and procedure manual that will not only contain policies and procedures for procurement within Arizona's regulatory framework, but also provide guidance and examples of best practices in key procurement processes.
2. The Department should continue with its plans to implement a process, policies, and procedures for conducting reviews at least once every 3 years of the procurement practices of state agencies with delegated procurement authority of \$100,000 or more.
3. In conjunction with its reviews of state agency procurement practices and as time and resources permit, the Department should annually review a random sample of individual procurements.
4. As part of its effort to develop a procurement policies and procedures manual, the Department should develop and implement policies, procedures, and/or guidelines for contract administration.
5. The Department should conduct a cost-benefit study of various options to determine the best approach for collecting and analyzing needed data on state contracting activities. Potential options for study include:
  - a. Using the current capability that exists on the Arizona Financial Information System (AFIS) to collect basic contracting information.
  - b. Identifying a new financial/accounting system to replace AFIS that has a procurement/contracting component with the ability to collect the desired contracting data.



# FINDING 3

## Department can improve its workers' compensation claims process

The Department can improve its workers' compensation claims process to help ensure that state employees who are injured while at work promptly receive benefits. The Department, through its workers' compensation unit in the Risk Management Office, is responsible for processing workers' compensation claims and determining eligibility for benefits. However, injured workers may experience delayed benefits because they do not fully understand their responsibilities for filing a claim. To reduce delays, Risk Management should better educate workers about the workers' compensation claims process. Other changes to Risk Management policies and procedures for claim processing and supervisory review may further reduce delays and help ensure that claims are appropriately processed.

### Workers' compensation claims process

The State of Arizona provides benefits to state employees for injuries arising out of and in the course of employment. The State provides this coverage through self-insurance and paid \$19.2 million for workers' compensation claims during fiscal year 2004, covering the costs of medical treatment and lost wages for injuries incurred by state employees with work-related injuries. Table 5 illustrates the number of claims submitted and dollar amount of claims paid in fiscal year 2004.

The Risk Management Workers' Compensation Unit administers claims according to laws governing both public and private employers

**Table 5:** Workers' Compensation Claims and Payments For the Year Ended June 30, 2004

Type of Claim	Number of Claims Submitted	Payments in Millions <sup>1</sup>
Medical only	2,628	\$ 2.3
Wage loss and medical	448	11.2
Long-term care	25	5.6

<sup>1</sup> These are the payments made during the year, regardless of when the claim was submitted.

Source: Auditor General staff analysis of the fiscal year 2004 workers' compensation frequency and severity table prepared by Risk Management.



and rules and regulations established by the Industrial Commission of Arizona (Commission). As prescribed by A.R.S. §23-1061(A), a workers' compensation claim must be filed with the Commission by the employee, or if resulting in death, by the parties entitled to compensation, within 1 year after the injury occurred or the right to the claim occurred. A claim is filed either through an employee's report of injury or a physician's report of injury documenting treatment of a work-related injury. Upon receiving a workers' compensation claim, the Commission will notify Risk Management, which has to accept or deny the claim within 21 days of the Commission's notification. If Risk Management fails to deny a claim within 21 days, an injured worker is entitled to immediate compensation as if the claim was approved. State employees often notify Risk Management when an injury occurs, making Risk Management aware of many upcoming claims even before they are filed with the Commission. Prior to accepting a claim, an investigation is typically needed to determine the cause and severity of the injury and its relationship to the course and scope of the employee's job. Risk Management can begin processing a claim before receiving notification from the Commission. The employee can reopen a workers' compensation claims at any time if there has been a change in the employee's medical condition relating to the claim.

Risk Management processes two categories of claims: (1) medical-only that request payment for all authorized medical care required to treat a work-related injury or illness, and (2) time-loss that request payment for medical care and lost wages that resulted from the injury or illness. An employee is entitled to payment for lost wages if more than 7 days are missed from work due to the injury.

## Risk Management could better communicate claim requirements

Although Risk Management meets the statutory time frame for processing claims, it can better serve state employees by improving its communication of claim filing and processing requirements. Specifically, injured state employees may be unaware of their responsibilities for filing a claim with the Commission and can therefore experience delays in receiving claim benefits. To resolve this problem, Risk Management should better communicate the claims filing process, employees' rights and obligations, and other information to state employees to help ensure that benefits are promptly processed.

Injured workers may experience delays in claims payment—Even though Risk Management meets the 21-day requirement for processing claims, meeting this standard is not an effective measure of the total time that elapses between an employee's injury and Risk Management's decision. Auditors reviewed a random sample of 43 workers' compensation claims submitted to Risk

Management during fiscal year 2004. Risk Management accepted or denied 35 of these claims within 21 days of receiving notification from the Commission. Risk Management processed the remaining 8 claims without receiving Commission notification.

However, considering the total time between an employee's injury and Risk Management's acceptance or denial of the claim, the results can be much different. Although statute requires the injured state employee to file a claim with the Commission, state employees may be unaware of the requirement, or some may rely on their physician to file an injury report with the Commission. As a result, weeks and even months could elapse between the time the injury occurs and the claim is formally filed. Because state employees often notify Risk Management when an injury occurs, Risk Management knew about all 35 claims prior to receiving formal notification from the Commission. For 17 of the 35 claims, Risk Management was aware of the injury at least 3 weeks before receiving the Commission's notification. While Risk Management actually reviewed and approved 6 of these 17 claims prior to receiving the notification, it took between 32 and 145 days for Risk Management to either approve or deny the other 11 claims from the date they were initially made aware of the injury.

Finally, even though injured employees may rely on their treating physician to notify the Commission, physicians are not reporting treatment of injured state employees to the Commission as required. According to administrative rule, the physician must submit a report of injury to the Commission within 8 days of treatment. However, auditor review of the 43 claims found that this requirement was met for only 8 of 39 claims where physicians submitted reports.

**Communication can improve benefit timeliness**—Risk management can prevent unnecessary benefit delays by improving communication with injured employees. Risk Management has established an automated telephone number and Web site to facilitate the reporting of work-related injuries. However, while the Web site provides information related to workers' compensation claim benefits, it provides limited and somewhat difficult-to-find instructions on how to file a claim and the need to report work-related injuries to the Commission. Additionally, Risk Management's automated phone system does not provide instructions to employees on how to proceed with a claim.

Risk Management should take steps to ensure injured employees clearly understand the workers' compensation claims process and their rights and responsibilities in this process. Specifically, through its automated phone system and Web site, Risk Management should clearly explain the workers' compensation claims process, actions that injured employees are required to take to file a claim, and the information and reports that Risk Management needs to process a claim. For example, the automated phone system could inform the injured employee that while Risk Management will take a report of injury, the employee must file a claim with the

Risk Management is often aware of claims before receiving the Commission's notification.

Risk Management should better inform injured employees of their rights and responsibilities.

Industrial Commission and that it is the employee's responsibility to ensure that his or her physician submits a report of injury to the Commission. Similarly, Risk Management's Web site should inform the injured employee of the importance of filling out a report of injury when treated by a physician, requesting that the physician immediately send reports to the Industrial Commission and Risk Management, asking all providers to send reports to Risk Management, and keeping adjusters informed of their work status.

The State Compensation Fund of Arizona, which is the largest provider of workers' compensation insurance in the State, uses its Web site to describe the claims filing process and how an injured employee can help process his/her claim in a prompt manner. The Fund's Web site also provides additional information that will help the employee facilitate the claims process, such as instructions for the employee to sign his/her name as it appears on the payroll check, requesting that physicians immediately send required reports to the Commission, and keeping adjusters informed of their current mailing address.

Additionally, as of March 1, 2005, Risk Management established and filled a customer relations coordinator position. In addition to other responsibilities, this position will serve as the central point of contact for providing information to and responding to questions from state employees and agencies.

## Enhanced policies and procedures should aid claims processing

Enhanced policies and procedures for processing workers' compensation claims should also help ensure that benefits are provided in a timely manner and help ensure more effective use of resources. While Risk Management recently adopted policies and procedures for its workers' compensation claims process, it should establish an additional procedure to promptly identify injured employees who have missed more than 7 days of work and monitor its revised supervisory review policies. Risk Management should also take steps to help ensure state agencies provide information on injured employees within the required time frame. Finally, Risk Management can better monitor the claims process by improving its data and developing additional management reports.

Newly adopted claims procedures need further revisions—In April 2005, Risk Management finalized and adopted policies and procedures for its workers' compensation claims process. Although these have been finalized, Risk Management should adopt procedures for promptly identifying time-loss claims, and should monitor the implementation of its revised supervisory review procedures. Specifically:

- **Promptly identifying time-loss claims**—Risk Management can better serve injured employees by adopting procedures to promptly identify time-loss claims. During the audit, Risk Management revised the questions it asks injured employees when they report an injury. Specifically, injured employees are prompted to call another telephone number if they have missed or anticipate missing more than 7 work days. However, since reports are usually made shortly after injuries occur, this procedure relies on employees who have not missed more than 7 work days to guess whether they might do so. Conversely, the State Compensation Fund employs a different approach to identifying time-loss claims. According to a State Compensation Fund administrator, fund adjusters are required to contact the employer and the physician 7 days after the initially reported date of work loss to determine the injured employee’s work status. Similarly, Risk Management should ask employees to identify the first day they missed time from work because of a work-related injury. For potential time-loss claims, adjusters should then contact the employee and/or agency supervisor 7 days after the injury occurred to determine if payment for time lost from work is due.
- **Monitoring supervisory review procedures**—Supervisory review of claims helps to ensure that adjusters appropriately process claims and address areas of deficiency. During the audit, Risk Management revised its policies and procedures for supervisory review. These policies and procedures require supervisors to review all new claims when assigned to their adjusters. This initial review occurs before claims have been researched, processed, and approved. Risk Management policy then requires a review of medical-only claims again within 90 days and then every 180 days thereafter; and time-loss claims again within 180 days and then as frequently as the supervisor deems necessary. Additionally, supervisors now review both medical-only and time-loss claims. Risk Management’s previous supervisory review procedures, where one supervisor was assigned the medical-only claims to review, while the other supervisor was assigned to review the time-loss claims, as well as the supervisor’s additional responsibilities, created a significant backlog of time-loss claims awaiting review. For example, as of September 28, 2004, the supervisor responsible for reviewing time-loss claims had yet to conduct reviews due in April 2004. With the change in review procedures and a reduction in supervisory responsibilities, a Risk Management official reported that a supervisor has begun to reduce the backlog of claims awaiting review. Therefore, the Department should monitor the implementation of its revised supervisory review procedures to ensure that the existing backlog of claims awaiting review is eliminated and that claims are reviewed as scheduled.

Additionally, Risk Management should standardize the supervisory review process. When reviewing claims, supervisors note in the claim files whether they agree or disagree with the steps performed to process the claim. However, this type of documentation does not ensure consistency in the application of policies

Risk Management should revise process for identifying time lost from work due to injury.

Risk Management revised its procedures for the supervisory review of claims.

and procedures, identify training needs, and ensure that appropriate feedback is provided regarding adjuster performance. The State Compensation Fund uses evaluation forms to review claims and to ensure consistency in the application of policies and procedures. As a result, the Department should develop a standard instrument for the supervisory review of claims, use this form to evaluate adjuster performance, and use the information collected to identify any training needs.

**Need to ensure agencies file injury reports**—Statute requires employers to complete and forward an injury report to the Commission and their insurer within 10 days of receiving notice of an injured employee. Specifically, not only must state agencies file an injury report with the Commission, they must also file an injury report with Risk Management, which administers the State’s self-insurance plan. Although not required by state law to do so, Risk Management can and does file the injury report with the Commission on behalf of state agencies. Timely receipt of the information contained in the report can also allow Risk Management to potentially begin the claims review process earlier. Risk Management has developed a supervisory report of injury to facilitate agencies’ reporting of injury-related information. However, auditors’ review of the 43 workers compensation claims determined that for 10 claims, agencies submitted a supervisory report of injury 11 to 42 days after the injured employee reported the injury to his or her supervisor. In addition, for 7 claims, agencies failed to submit the required information.

Administrative rule provides Risk Management with the authority to charge agencies a deductible for not reporting a claim within the required 10 days. However, given the effort required to collect and maintain the historical data needed to determine the deductible, as well as the relatively low cost of most claims, the state risk manager indicated that it has not been cost-effective to determine, assess, and then collect this deductible. As a result, Risk Management is in the process of eliminating this provision from its administrative rules.

Risk Management should explore various options for obtaining the information it needs from state agencies within the 10 days. One option would be for Risk Management to establish procedures for obtaining the necessary information from state agencies when it has not been provided in a timely manner. This might include a letter, e-mail, or telephone call requesting the needed information from state agencies. While some adjusters do contact agencies when this information has not been received, this is not an established procedure within Risk Management. Another option would be for Risk Management to adopt an administrative rule establishing a penalty, such as a flat fee, for noncompliance with the statutory reporting requirement.

Risk Management should also provide guidance to agencies on how to report this information. Auditor interviews with four state agency risk management liaisons found that these agencies know they need to report injury information in a timely manner.

However, one liaison requested additional guidance regarding the forms they should use to report injuries, while all four indicated that Risk Management does not provide feedback related to the timeliness of their reporting.

**Risk Management should improve claims monitoring**—To more effectively monitor its claims process, Risk Management should improve the integrity of its automated data and then develop additional management reports for monitoring the claims process. Risk Management should first ensure that information in its claims management system is accurate. Auditors identified some problems that can lead to inaccurate data. For example, according to a Risk Management supervisor, some claims' closed dates may be inaccurate, since claims adjusters use different criteria for when to close a claim. To ensure its data is accurate, Risk Management should develop procedures directing staff on data-entry requirements, including defining key terms and dates.

Risk Management can then more effectively monitor the claims process by developing additional management reports. Such reports can help identify claims that may have not been processed according to policies and procedures. While Risk Management has developed and continues to develop reports that allow management to review such things as the number of claims opened or closed per each adjuster, auditors identified additional items that require more systematic monitoring. For example, Risk Management may want to pay closer attention to its denied claims to ensure its policies are being followed. Auditors' review of five claims that were initially denied, but subsequently accepted during fiscal year 2004, found that some adjusters did not follow Risk Management's denial policy, which requires that proposed denied claims be presented to a group of peers or a supervisor before being denied.<sup>1</sup> Some other reports that Risk Management may want to create include a report on claims where a certain number of days have passed since injury and notification has not been received from the Commission, and a report that identifies medical-only claims that have been open for an extended period of time and/or have significant expenditures. Reviewing such reports would allow management to be more systematic and complete in monitoring and addressing any problems. In April 2005, Risk Management reported that it began using report development software to enhance its ability to create management reports.

Risk Management should develop additional management reports to monitor claims.

<sup>1</sup> Overall, reports indicate that Risk Management denied 364 out of 3,116 claims in 2003 and subsequently reversed 95 that were first denied.

## Recommendations

1. Risk Management should take steps to ensure that injured employees clearly understand the workers' compensation claims process and their rights and responsibilities in this process. Specifically:
  - a. Through its automated phone system and Web site, Risk Management should explain the workers' compensation claims process, actions that injured employees are required to take to file a claim, and the information and reports that Risk Management needs to process a claim; and
  - b. Risk Management should expand the information on its Web site to inform injured employees of the importance of filling out a report of injury when treated by a physician, requesting that the physician immediately send reports to the Industrial Commission and Risk Management, asking all medical providers to send reports to Risk Management, and keeping adjusters informed of their work status.
2. Risk Management should improve its policies and procedures for claims processing by:
  - a. Adopting procedures to more promptly identify time-loss claims by asking injured employees to identify the first day they missed time from work because of a work related injury, and then for potential time-loss claims, contacting the employee and/or agency supervisor 7 days after the injury occurred to determine if payment for time lost from work is due;
  - b. Monitoring its revised supervisory review policy to ensure that the existing backlog of claims awaiting review is eliminated and that claims are reviewed as scheduled; and
  - c. Developing a standard instrument for the supervisory review of claims, using this form to evaluate adjuster performance, and then using the information collected to identify any training needs.
3. Risk Management should explore options for obtaining the information it needs from state agencies in a timely manner. These options include:
  - a. Sending a letter or e-mail, or making a telephone call requesting the needed information from state agencies; and
  - b. Adopting an administrative rule establishing a penalty, such as a flat fee, for noncompliance with the statutory reporting requirement.
4. Risk Management should provide guidance to agencies on how to report injury information, as well as periodically informing them whether they are providing injury information in a timely manner.
5. To help ensure the accuracy of information in its claims management system, Risk Management should develop procedures directing staff on data-entry requirements, including defining key terms and dates.
6. Risk Management should more effectively monitor the claims process by developing additional management reports for key items in the workers' compensation claims process.

# OTHER PERTINENT INFORMATION

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As part of this audit, auditors gathered other pertinent information regarding the certificates of participation (certificates) that the State issued to help fund the development and implementation of the Human Resource Information Solution (HRIS) system. To cover the debt service for these certificates, the Department has requested that the Legislature increase state agency charges for personnel administration services. Without an increase in revenues from this charge, beginning in fiscal year 2005, department projections show that it will have insufficient funds to service the debt and fund its Human Resources Division budget.

## Certificates of Participation

In April 2002, the State, through the Department of Administration, issued \$63.27 million in Series 2002A Certificates of Participation. The State issued these certificates to finance a portion of the costs of the acquisition, construction, and improvement of a new state health laboratory for the Department of Health Services, Bureau of State Laboratory Services, and to help fund the acquisition, design, and implementation of a new human resources information system. The sale of these certificates, which are insured and collateralized by the assets funded with the proceeds, generated over \$65.7 million. The HRIS project received approximately \$35 million of this amount.

The State has used certificates of participation to fund several large projects. For example, the Arizona School Facilities Board issued certificates in 2003 to help fund the construction of new schools, while the Department issued certificates in 2004 to finance prison construction. Certificates of participation function similarly to a lease-purchase agreement, because these securities are backed by the assets funded by the certificate proceeds, and nonpayment of the lease payments can result in the State returning possession of the assets to the trustee.

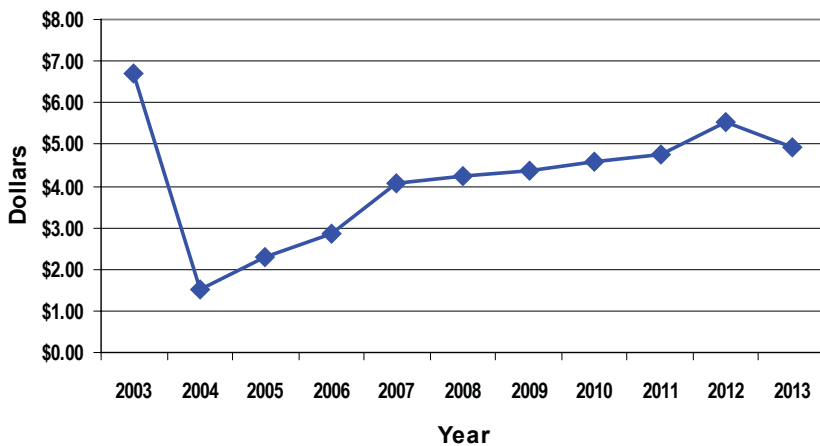
Certificates of participation allow the State to fund large capital projects without incurring debt and violating the State Constitution. The Arizona Constitution only allows the State to incur a total of \$350,000 in debt. However, as specified in the official statement for the Series 2002A certificates, the State's obligation to make lease payments does not constitute a debt or liability of the State and is dependent

The State issued certificates of participation to help fund HRIS development.



upon annual appropriations being made by the Legislature and annual allocations of such appropriations being made by the Department to make the lease payments. The official statement also specifies that the Department agrees to use its best efforts to budget, obtain, allocate, and maintain sufficient appropriated monies to make lease payments. Additionally, statute requires the Attorney General to review the issuance of certificates of participation to ensure they comply with A.R.S. §41-791.02, which authorizes the department director to enter into lease purchase agreements. As part of its annual state-wide financial audit, the Office of the Auditor General also reviews the certificates of participation to ensure that the State and designated state agency comply with all terms and covenants.

**Figure 1:** Human Resources Information Solution (HRIS) Scheduled Certificate of Participation Payments, in Millions Eleven Years Ending May 1, 2013



Source: Auditor General staff analysis of the Series 2002A Certificate of Participation Official Statement repayment schedule.

Although the portion of the certificates issued for the state health laboratory will not be retired until 2023, the HRIS portion of these certificates is due to be retired in 2013. As illustrated in Figure 1, the payment schedule for the HRIS portion of the certificates varies during the 11-year debt service period. Specifically, the Department was required to make two payments totaling over \$6.72 million in fiscal year 2003, but the required payments for fiscal year 2004 dropped to slightly over \$1.5 million. However, the payments increase each fiscal year until fiscal year 2012, when the Department will need to make over \$5.54 million in payments. In fiscal year 2013, the Department needs to make nearly \$4.95 million in payments, which will satisfy the HRIS portion of these certificates. Total payments are projected to cost \$45.84 million for the HRIS portion of the certificates.

The Legislature has authorized the Department to use part of the revenues generated from state agency charges for personnel administration services to satisfy the payments for the HRIS portion of the Series 2002A certificates. These charges, which are used to fund the Department's Human Resources Division budget, are assessed against the System A state agencies and deposited into the Personnel Division Fund.<sup>1</sup> For fiscal year 2005, the General Appropriations Act established this charge at 1.04 percent of System A state agency payrolls. According to the Department's fiscal year 2006 budget submission, when the Series 2002A certificates were issued, the Department assumed that System A state agency payrolls would grow, resulting in a growing revenue stream from the payroll charge. According to a department

<sup>1</sup> System A agencies are agencies covered by the State's personnel merit system, and therefore must adhere to the State's personnel rules and regulations. Conversely, non-System A agencies are agencies not covered by the State's personnel merit system.

official, revenue growth from these charges were expected to keep pace with the increasing lease payments for the payment schedule's first 3 to 5 years. Specifically, revenue from payroll charges were estimated to grow by 13.6 percent in fiscal year 2003 and then by 2.5 percent annually for fiscal years 2004 through 2007. However, according to a department schedule, actual revenues from these charges increased 11.7 percent in fiscal year 2003, with virtually no growth in these revenues for fiscal year 2004.

As such, beginning in fiscal year 2005, the Department projects that revenues will not be sufficient to satisfy these payments and fund its Human Resources Division budget. As illustrated in Table 6, beginning in fiscal year 2005, the Department begins to show a budget deficit of \$180,000, and this deficit continues as the amount required for the lease payments increases. Even though the Department projects a 4.2 percent growth in agency payroll on which the payroll charge is assessed, this growth does not keep pace with the required debt service. As a result, in its fiscal year 2006 budget submission, the Department has requested an increase in the Personnel Division Fund charge to 1.08 percent of System A agency payrolls.

Dedicated revenues may be insufficient to satisfy debt payments.

**Table 6:** Human Resources Division  
Projected Budget Shortfall, in Millions  
Years Ending June 30, 2005 through 2007

	2005	2006	2007
Total Receipts <sup>1</sup>	<u>\$14.39</u>	<u>\$15.01</u>	<u>\$15.64</u>
Less:			
Personnel services	7.11	7.11	7.11
Employee-related expenses	2.01	2.01	2.01
Other operating expenses	1.84	1.84	1.84
Debt service	2.30	2.84	4.08
Other miscellaneous	<u>1.31</u>	<u>1.31</u>	<u>1.31</u>
Subtotal	<u>\$ 14.57</u>	<u>\$ 15.11</u>	<u>\$16.35</u>
Budget deficit:	<u>\$( 0.18)</u>	<u>\$( 0.10)</u>	<u>\$( 0.71)</u>

<sup>1</sup> Assumes growth in agency payrolls of 4.2 percent each year. In addition, the 2005 total receipts includes a beginning balance of \$517,500.

Source: Auditor General staff analysis of the Arizona Department of Administration's fiscal year 2006 budget submission and supporting documents.



# AGENCY RESPONSE





**Janet Napolitano**  
Governor

**Betsey Bayless**  
Director

**ARIZONA DEPARTMENT OF ADMINISTRATION**

**OFFICE OF THE DIRECTOR**

100 North 15<sup>th</sup> Avenue • ROOM 401  
PHOENIX, ARIZONA 85007

(602) 542-1500

June 8, 2005

Debbie Davenport  
Auditor General  
2910 North 44<sup>th</sup> Street, Suite 410  
Phoenix, AZ 85018

Dear Ms. Davenport:

Thank you for the cooperation of your review team during the site visit and subsequent discussions. We are appreciative of the efforts of your team to make the time to listen and understand the complexities of our business.

Please find enclosed our agency's comments on the revised preliminary report draft of the performance audit and sunset review of the Arizona Department of Administration, Financial Services Division.

Our goal is to serve the citizens and employees of the state of Arizona in the most effective and efficient manner possible. We appreciate the feedback and recommendations from your Office that will help us improve the management and operations of our agency.

Very truly yours,

Betsey Bayless  
Director

Enclosure

## **ADOA Agency Response, by Section and Finding**

### ***Program Fact Sheet – General Accounting Office***

#### **Agency Response:**

The Department finds the fact sheet accurate. But there is an important detail about the General Accounting Office that was beyond the scope of the fact sheet which cannot go without comment. Specifically, the General Accounting Office (GAO) is experiencing a severe employee turnover problem that threatens the ability of that office to provide timely and accurate accounting information to the state. In general, GAO cannot attract new employees and retain existing employees due to deficiencies in salaries that place the state significantly below market rates for accountants. The Governors' budget recommendation for FY 2006 included \$454,200 from the General Fund to address this problem. Ultimately this recommendation was not funded in the FY 2006 budget.

ADOA was informed that the Auditor General will address this issue in a separate letter to the Joint Legislative Budget Committee. ADOA would appreciate that a copy of this letter be provided to legislators, just as the performance audit will be. Because of the severity of the problem and the potential for adverse statewide results, ADOA must continue to inform state decision makers about this issue.

#### ***Finding 1 – ADOA needs comprehensive plan to ensure completion of HRIS system***

#### **Agency Response:**

Two years ago, the State was faced with a significant challenge. The existing payroll system (HRMS) was obsolete, key software components were no longer supported by vendors, and the State was facing a severe budget crisis. The Department overcame this challenge and successfully implemented the State's first integrated payroll, personnel and benefits system (HRIS). This was a significant accomplishment given the diversity and complexity of state government. It required the Department and all state agencies to work together to achieve technical readiness, agree on business practices and prepare staff to embrace a new way of doing business.

The Department of Administration believes that the recommendations in the audit report pertaining to HRIS represent the Department's efforts to be customer focused and to have sound planning processes in place. We, therefore, generally support the recommendations outlined.

Approximately six months ago, the Department made a strategic decision to move the leadership of HRIS into the Human Resources Division. This move served to focus attention on strategic planning, customer involvement and managing the system as an integral part of the division.

Significant strides have already been made not only to ensure the core payroll system is stabilized but to deploy the additional functionality of HRIS in a methodical and customer oriented manner. Tremendous efficiencies are already being realized as the additional functionality is implemented throughout state government using customer involvement and structured planning. For example, one agency has already experienced a 35% improvement in the time to hire after fully implementing the new Hiring Gateway feature of HRIS.

A comprehensive plan will be in place as we consolidate the current plans of system upgrades, tactical efforts (i.e. open enrollment, end of year processing, etc.) and implementation of additional features. Another key component of this plan will include the customer requirements over the next two to five years as we work with agencies to strategically prioritize the future direction of HRIS.

With regard to the budget analysis of HRIS, it is important to note that of the \$7.5 million appropriated for the project outside of the \$35 million generated through the Certificate of Participation, nearly \$6 million was for debt service. ADOA believes that the financing costs of the project are separate costs from the actual project development. The approved ADOA budget during the fiscal years of the project implementation mirrors that belief.

## **Recommendations**

*Recommendation #1 – “The Department, in collaboration with the user community, should develop a comprehensive plan to direct the completion of the HRIS system. This plan should specify the goals and objectives for completing the project, and the remaining functions to be implemented; and identify a process for addressing user requests for system features and changes, and the funding, staff resources, and time frames for completing the system’s remaining functions and fully implementing the system.”*

## **Agency Response:**

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

The HRIS Executive Committee has been meeting on a regular basis to direct the planning and implementation of the remaining functionality of the HRIS system. Action plans have been developed for key elements of the operation, and input from the customers will be solicited to develop long-range planning and to aid in the prioritization of enhancements.



*Recommendation #2 – The Department should follow its process for formally assessing the impact of requested system changes and for approving their implementation and priority on the list of items awaiting action.*

**Agency Response:**

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

The HRIS team has an established process for assessing requested changes to the system. This is a necessary process to ensure adequate review of the impact of the proposed changes and an estimate of the impact to the staff (e.g. programming and testing hours). The agency will ensure that a formalized process will be followed for all requested system changes.

*Recommendation #3 – The Department should continue to address the concerns with its acceptance testing process, including developing a testing methodology, individual test plans, and documenting test results.*

**Agency Response:**

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

The HRIS team has an established testing methodology that is used for all system enhancements and programming changes. The agency will ensure that this process is adhered to for all system changes.

*Recommendation #4 – The Department should enhance user participation in the HRIS project by:*

- a. Following through with its plans to involve users in the development of a comprehensive plan to direct the completion of HRIS;*
- b. Establishing documented processes by which the executive committee obtains, considers, and takes action on user input regarding overall project policy, and by which the project team obtains user participation and approval at critical project phases;*
- c. Including users in the process for prioritizing system changes; and*
- d. Involving users in all phases of system design and acceptance testing.*

## **Agency Response:**

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

Gathering input from the end-user has been an important practice from the beginning of the project. In fact much of the complexity of our current system is due to the many modifications that have been made – modifications that were requested by the customers. As any Phase 2 components are being rolled out to the user community, a customer user group is established for planning and testing purposes. We will continue this strategy.

## ***Finding 2 - Planned changes should improve procurement oversight, but more can be done***

### **Recommendations:**

*Recommendation #1 – The Department should continue with its plans to develop and implement a state-wide procurement policy and procedure manual that will not only contain policies and procedures for procurement within Arizona’s regulatory framework, but also provide guidance and examples of best practices in key procurement processes.*

*Recommendation #2 – The Department should continue with its plans to implement a process, policies, and procedures for conducting reviews at least once every 3 years of the procurement practices of state agencies with delegated procurement authority of \$100,000 or more.*

*Recommendation #3 – In conjunction with its review of state agency procurement practices and as time and resources permit, the Department should annually review a random sample of individual procurements.*

*Recommendation #4 – As part of its effort to develop a procurement policies and procedures manual, the Department should develop and implement policies, procedures, and/or guidelines for contract administration.*

*Recommendation #5 – The Department should conduct a cost-benefit study of various options to determine the best approach for collecting and analyzing needed data on state contracting activities. Potential options for study include:*

- a. *Using the current capability that exists on the Arizona Financial Information System (AFIS) to collect basic contracting information.*
- b. *Identifying a new financial/accounting system to replace AFIS that has a procurement/contract component with the ability to collect the desired contracting data.*

**Agency Response:**

All of the findings of the Auditor General are agreed to and the audit recommendations will be implemented.

***Finding 3 - Department can improve its workers' compensation claims process***

***Recommendations:***

*Recommendation #1- Risk Management should take steps to ensure that injured employees clearly understand the workers' compensation claims process and their rights and responsibilities in this process. Specifically:*

- a. *Through its automated phone and Web site, Risk Management should explain the workers' compensation claims process, actions that injured employees are required to take to file a claim, and the information and reports and report that Risk Management needs to process a claim; and*
- b. *Risk Management should expand the information on its Web site to inform injured employees of the importance of filling out a report of injury when treated by a physician, requesting that the physician immediately send reports to the Industrial Commission and Risk Management, asking all medical providers to send reports to Risk Management, and keeping adjusters informed of their work status.*

**Agency Response:**

1a. The finding of the Auditor General is agreed to and the audit recommendation will be implemented. Our Web site, employee brochures and injured worker welcome letters will be revised to add additional information.

1b. The finding of the Auditor General is agreed to and the audit recommendation will be implemented. Our web site, employee brochures and injured worker welcome letters will be revised to add additional information.

*Recommendation #2 – Risk Management should improve its policies and procedures for claims processing by:*

- a. *Adopting procedures to more promptly identify time-loss claims by asking injured employees to identify the first day they missed time*

*from work because of a work related injury, and then for potential time-loss claims, contacting the employee and/or agency supervisor 7 days after the injury occurred to determine if payment for time lost from work is due;*

- b. Monitoring its revised supervisory review policy to ensure that the existing backlog of claims awaiting review is eliminated and that claims are reviewed as scheduled; and*
- c. Developing a standard instrument for the supervisory review of claims, using this form to evaluate adjuster performance, and the using the information collected to identify any training needs.*

**Agency Response:**

2a.The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

2b.The finding of the Auditor General is agreed to and the audit recommendation will be implemented. The backlog of claims waiting for supervisory review has been eliminated.

2c.The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

*Recommendation #3 – Risk Management should explore options for obtaining the information it needs from state agencies in a timely manner. These options include:*

- a. Sending a letter or e-mail, or making a telephone call requesting the needed information from state agencies; and*
- b. Adopting an administrative rule establishing a penalty, such as a flat fee, for noncompliance with the statutory reporting requirement.*

**Agency Response:**

3a.The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

3b.The finding of the Auditor General is agreed to and a different method of dealing with the finding will be implemented. A thorough review of the potential options for penalties will be conducted and a rule change will be proposed that provides for the most effective means of dealing with late reporting. Establishing a flat fee penalty may not be the best option.

*Recommendation #4 – Risk Management should provide guidance to agencies on how to report injury information, as well as periodically informing them whether they are providing injury information in a timely manner.*

**Agency Response:**

The finding of the Auditor General is agreed to and the audit recommendation will be implemented. Our new Customer Relations Coordinator has begun meetings and training with agencies on this subject. A seminar was held on 5/17/2005 for Workers' Compensation Liaisons on reporting criteria and to exchange information. 67 agency liaisons attended. We are also planning several mini seminars for selected large agencies.

*Recommendation #5 – To help ensure the accuracy of information in its claims management system, Risk Management should develop procedures directing staff on data-entry requirements, including defining key terms and dates.*

**Agency Response:**

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

*Recommendation #6 – Risk Management should more effectively monitor the claims process by developing additional management reports for key times in the workers' compensation claims process.*

**Agency Response:**

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

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

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<b>03-05</b>	Department of Economic Security—Child Protective Services—Foster Care Placement Stability and Foster Parent Communication	<b>04-07</b>	Department of Environmental Quality—Air Quality Division
<b>03-06</b>	Arizona Board of Appraisal	<b>04-08</b>	Department of Environmental Quality—Sunset Factors
<b>03-07</b>	Arizona Board for Charter Schools	<b>04-09</b>	Arizona Department of Transportation, Motor Vehicle Division— State Revenue Collection Functions
<b>03-08</b>	Arizona Department of Commerce	<b>04-10</b>	Arizona Department of Transportation, Motor Vehicle Division—Information Security and E-government Services
<b>03-09</b>	Department of Economic Security—Division of Children, Youth and Families Child Protective Services— Caseloads and Training	<b>04-11</b>	Arizona Department of Transportation, Motor Vehicle Division—Sunset Factors
<b>04-L1</b>	Letter Report—Arizona Board of Medical Examiners	<b>04-12</b>	Board of Examiners of Nursing Care Institution Administrators and Assisted Living Facility Managers
<b>04-L2</b>	Letter Report—Gila County Transportation Excise Tax	<b>05-L1</b>	Letter Report—Department of Health Services— Ultrasound Reviews
<b>04-01</b>	Arizona Tourism and Sports Authority	<b>05-01</b>	Department of Economic Security—Unemployment Insurance
<b>04-02</b>	Department of Economic Security—Welfare Programs		
<b>04-03</b>	Behavioral Health Services' HB2003 Funding for Adults with Serious Mental Illness		
<b>04-04</b>	Department of Emergency and Military Affairs and State Emergency Council		
<b>04-05</b>	Department of Environmental Quality—Water Quality Division		
<b>04-06</b>	Department of Environmental Quality—Waste Programs Division		

## Future Performance Audit Division reports

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Government Information Technology Agency and Information Technology Authorization Committee

Department of Economic Security—Information Technology

Department of Economic Security—Service Integration