



A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Sunset Review

Department of Administration— Sunset Factors

SEPTEMBER • 2005
REPORT NO. 05 – 13



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.

The Joint Legislative Audit Committee

Senator **Robert Blendu**, Chair

Senator **Carolyn Allen**

Senator **Gabrielle Giffords**

Senator **John Huppenthal**

Senator **Harry Mitchell**

Senator **Ken Bennett** (*ex-officio*)

Representative **Laura Knaperek**, Vice Chair

Representative **Tom Boone**

Representative **Ted Downing**

Representative **Pete Rios**

Representative **Steve Yarbrough**

Representative **Jim Weiers** (*ex-officio*)

Audit Staff

Melanie Chesney, Director

Dale Chapman, Manager and Contact Person

Tara Nielson

Copies of the Auditor General's reports are free.
You may request them by contacting us at:

Office of the Auditor General

2910 N. 44th Street, Suite 410 • Phoenix, AZ 85018 • (602) 553-0333

Additionally, many of our reports can be found in electronic format at:

www.auditorgen.state.az.us



DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

September 28, 2005

Members of the Arizona Legislature

The Honorable Janet Napolitano, Governor

Jerry Oliver, Interim Director
Department of Administration

Transmitted herewith is a report of the Auditor General, A Sunset Review of the Department of Administration. This report is in response to a November 20, 2002, resolution of the Joint Legislative Audit Committee and was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq.

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

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

This report will be released to the public on September 29, 2005.

Sincerely,

Debbie Davenport
Auditor General

Enclosure

TABLE OF CONTENTS



Introduction & Background	1
Sunset Factors	7
Agency Response	
Table:	
1 Schedule of Administrative Revenues and Expenditures, in Thousands Years Ended June 30, 2003, 2004, and 2005 (Unaudited)	5
	♦ concluded

INTRODUCTION & BACKGROUND

The Office of the Auditor General has conducted a review of the Arizona Department of Administration (Department) using the 12 criteria in Arizona's sunset law. The analysis of the 12 sunset factors was conducted pursuant to a November 20, 2002, resolution of the Joint Legislative Audit Committee and prepared as part of the sunset review set forth in Arizona Revised Statutes (A.R.S.) §41-2951 et seq.

This sunset review is the last in a series of four reports of the Department. The other three reports were performance audits of the Department's Financial Services Division, the Information Services Division and Telecommunications Program Office, and the Human Resources Division.

Organization

The Department is divided into nine functional areas. As of July 2005, the Department reported it had 937.37 staff positions, with 132.21 vacancies. In addition to the director's office, which includes 7 filled positions, department staff work in the following areas:

- **Arizona Government University (12.75 filled positions)**—Arizona Government University (AzGU) administers the State's centralized employee training activities. It develops standardized curriculum, provides agencies with information on outside training vendors, and partners with the State's community colleges and universities to provide college credit for some courses. AzGU courses include ethics, management development, health and safety, and time and project management.
- **Enterprise Procurement Services (30 filled positions)**—Enterprise Procurement Services (EPS) was created in January 2005 and replaces the State Procurement Office as the central procurement authority for the State. EPS conducts strategic state-wide contracting for specific goods and services, and procurements for individual agencies when the value of the procurement exceeds the agency's delegated procurement authority or upon request.¹ EPS

¹ 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. Arizona Administrative Code also authorizes the department director to delegate procurement authority to state agencies.

also establishes and administers procurement policies and procedures, establishes standards and manages procurement authority delegated to agencies, and administers bid protests and claims appeals. Further, EPS works with state agencies and political subdivisions to provide access to the EPS Web site and automated procurement systems.

- **General Accounting Office (61 filled positions)**—The General Accounting Office (GAO) is the State's principal accounting office. It 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 and the state-wide payroll portion of the Human Resources Information Solution. 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.
- **Human Resources Division (143.75 filled positions)**—The Human Resources Division provides a variety of services to state agencies and their employees. The division administers the State's self-funded health benefits program, manages state employee counseling and wellness programs, maintains the State's job classification and compensation system, reviews employee grievances involving discrimination or a violation of personnel rules, maintains and administers the State's Human Resources Information Solution system, and maintains the State's new online hiring and recruiting software. The division also provides human resources services at the division's seven satellite offices, located at various state agencies and in Tucson; and manages a worklife benefits program that focuses on nonsalary-related employee benefits, such as on-site child care, alternative work schedules, and flex time, to help agencies enhance recruitment and employee retention.
- **Information Technologies and General Services (239.6 filled positions)**—Information Technologies and General Services is composed of the Information Services Division and the General Services Division. These divisions perform the following activities:
 - **Information Services Division**—This division provides information technology services and support both within the Department and to approximately 50 other state agencies such as the Arizona Health Care Cost Containment System and the Departments of Transportation and Revenue. Services and support include activities such as mainframe and other types of data processing, creating and maintaining Web sites, and maintaining and providing technical support for the Department's internal network. The Department's Data Center operates 24 hours per day, 7 days

per week. Further, the division administers the Department's 9-1-1 telecommunications services, which provide guidance and direction to the various 9-1-1 programs across the State, and administers and disburses the 9-1-1 excise tax that is deposited into the emergency telecommunication services revolving fund.

- **General Services Division**—This division manages and operates 2,419 state-owned buildings and properties throughout Arizona, including administering the acquisition, leasing, planning, inspection, and construction of state facilities, and overseeing compliance with statutory and building codes. The division also works with the Department of Corrections and Juvenile Corrections to plan correctional facilities projects and, as of July 2005, is overseeing the construction of three state prison facilities. The Capitol Police, which are housed in this division, provide 24-hour public and employee protection at the Capitol Mall and Tucson Complex.
- **Legal Services (7 filled positions)**—Legal Services provides counsel on legal issues throughout the Department, including advice regarding the Arizona Procurement Code. It includes the HIPAA Compliance Office and the Governor's Regulatory Review Council, which has its own sunset date of July 1, 2007.¹
- **Maintenance and Facilities (204.5 filled positions)**—Maintenance and Facilities includes the Management Services Division and the Facilities Operations Division. These divisions perform the following activities:
 - **Management Services Division**—This division provides internal accounting services for all department divisions. It oversees the State Boards Office, which provides accounting services to small boards and commissions. The division also manages all mandated travel reduction programs, which encourage state employees in Maricopa County to carpool, bus, bicycle, or walk to work, and telecommute; and houses the Arizona Office for Americans with Disabilities, which provides technical assistance, training, and guidance relevant to the Americans with Disabilities Act and other disability-related legislation. Further, the division provides services for printing, office machine repair, and mail handling; manages a fleet of 1,767 vehicles for state agency use; and manages the surplus property program.
 - **Facilities Operations Division**—This division provides custodial, grounds, and maintenance activities, such as painting, plumbing, window washing, and heating and ventilation repair. It is responsible for managing and maintaining the State's physical assets and ensuring compliance with

¹ HIPAA, the Health Insurance Portability and Accountability Act of 1996, primarily affects the operations of the Department's employee healthcare program and the occupational wellness program, as well as the use of healthcare information in the operations of the Arizona Health Care Cost Containment System, and the Departments of Health Services and Economic Security.

safety codes, environmental regulations, and other external compliance and regulatory matters.

- **Risk Management (89.56 filled positions)**—Risk Management managed approximately \$51.7 million in property, liability, and workers' compensation claims costs for the State in fiscal year 2004. 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 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.
- **Telecommunications Program Office (10 filled positions)**—The Telecommunications Program Office provides oversight for the State's privatized telecommunications services contractor and AZNET, the State's privatized telecommunications network. In January 2005, the Department awarded a 5-year, approximately \$40 million dollar annual contract to provide telecommunications services for all executive branch agencies, including telecommunications, telephone maintenance, long distance, Internet, and other services. The same contractor will develop a unified state voice and data network for executive branch agencies called AZNET, which will allow agencies to contact each other directly over the network, reducing local and long-distance service charges.

Operating budget

While the Department's operating budget consists of monies appropriated from the State General Fund, it also receives revenues from other funding sources, including charges assessed to state agencies for the various services it provides. Table 1 (see page 5) illustrates the Department's actual revenues and expenditures for fiscal years 2003 and 2004, and its estimated revenues and expenditures for fiscal year 2005. The Department received an estimated \$126.2 million in revenues in fiscal year 2005, nearly \$17.9 million of which consisted of General Fund appropriations. The Department also received estimated revenues of approximately \$101.3 million in fiscal year 2005 from state agency charges for the various services that it provides. The Department's fiscal year 2005 expenditures were an estimated \$106.7 million, which represented a 10.4 percent decrease from its fiscal year 2004 expenditures of nearly \$119.1 million.

Table 1: Schedule of Administrative Revenues and Expenditures, in Thousands
Years Ended June 30, 2003, 2004, and 2005
(Unaudited)

	2003 (Actual)	2004 (Actual)	2005 (Estimated)
Revenues:			
State General Fund appropriations	\$ 16,597	\$ 17,339	\$ 17,885
Charges for services	106,682	108,890	101,343
Other	<u>5,614</u>	<u>6,840</u>	<u>6,949</u>
Total revenue	<u>128,893</u>	<u>133,069</u>	<u>126,177</u>
Expenditures and transfers:			
Personal services and employee-related	40,913	42,189	42,360
Professional and outside services	4,479	8,439	7,729
Travel	465	441	429
Other operating ¹	40,392	48,662	41,257
Equipment and other capital purchases	17,306	18,161	14,141
Allocated costs	<u>683</u>	<u>1,198</u>	<u>744</u>
Total expenditures	<u>104,238</u>	<u>119,090</u>	<u>106,660</u>
Net operating transfers out	<u>1,005</u>	<u>806</u>	<u>1,559</u>
Total expenditures and operating transfers	<u>105,243</u>	<u>119,896</u>	<u>108,219</u>
Excess of revenues over expenditures and operating transfers ²	<u>\$ 23,650</u>	<u>\$ 13,173</u>	<u>\$ 17,958</u>

¹ Includes various expenditures, such as insurance, telecommunications, printing, data processing, utilities, repair and maintenance, and rental costs.

² The Department reports that the excess of revenues over expenditures is primarily attributable to charges for services to other state agencies in excess of the Department's costs to provide for the accumulation of reserves for future purchases of motor pool cars, telecommunications and other capital purchases, and implementation of enhanced 9-1-1 services.

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 ended June 30, 2005. (Actual information was not available at the time of this report.)

Scope and methodology

The Department's performance was analyzed in accordance with the 12 statutory sunset factors. The following audits were completed:

- Financial Services Division (Auditor General Report No. 05-02).
- Information Services Division and Telecommunications Program Office (Auditor General Report No. 05-11).

- Human Resources Division (Auditor General Report No. 05-12).

This report also includes information obtained from department officials and the Governor's Regulatory Review Council, as well as from a review of statutes, administrative rules, department policies and procedures, the 2004-2006 Arizona Master List of State Government Programs, and the Department's Web site.

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 throughout this audit.

SUNSET FACTORS

In accordance with A.R.S. §41-2954, the Legislature should consider the following 12 factors in determining whether the Arizona Department of Administration (Department) should be continued or terminated. The three performance audits identified areas that the Department has operated efficiently and effectively, as well as opportunities for the Department to improve operations. The evidence assembled under these 12 factors indicates the continued need for the Department.

1. The objective and purpose in establishing the Department.

The Arizona Department of Administration was established in 1972 by A.R.S. §41-701. This statute created the Department by merging seven previously established agencies to provide more centralized support services to state government. The agencies that were merged included the Departments of Library and Archives, Public Buildings Maintenance, and Finance; the State Surplus Property Agency; the Historical Advisory and State Personnel Commissions; and the Board of History and Archives.¹

The Department defines its mission as follows:

“To provide effective and efficient support services to enable government agencies, state employees, and the public to achieve their goals.”

The Department performs several functions, many of which involve the provision of different services to state agencies and their employees. These functions and services include the following:

- **Accounting**—The Department manages accounts receivable and payable, processes state employee payroll, prepares the State’s annual financial statements, provides external accounting services to state agencies, adopts state-wide accounting policies and procedures, operates the state-wide accounting system (AFIS), and performs internal audits, reviews, and investigations of state agencies.

¹ The Department of Library and Archives, the Historical Advisory Commission, and the Board of History and Archives are no longer part of the Department. In 1976, the Department of Library and Archives became a legislative agency, and the Board of History and Archives and the Historical Advisory Commission were placed under the Department of Library and Archives.

- **Procurement**—Statute designates the department director as the State’s central procurement officer, responsible for procuring or supervising the procurement of all materials, services, and construction that the State needs. As such, the Department conducts strategic state-wide contracting for specific goods and services, and 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 for all state agencies; delegates procurement authority to state agencies; and administers bid protests and claims appeals.
 - **Facilities management**—The Department manages and operates 2,419 state-owned buildings and properties, and provides ongoing custodial, maintenance, heating and air conditioning, and landscaping services to these properties. The Department also oversees prison and building construction; and the acquisition, leasing, planning, and construction of state facilities.
 - **Human resources**—The Department establishes and administers state personnel rules and policies; administers the State’s self-funded health benefits program, as well as dental, vision, and life insurance for state employees, retirees, and their dependents; provides personnel services for staffing and recruitment, workforce relations, and classification and compensation; and maintains and administers the State’s Human Resources Information Solution system.
 - **Information technology**—The Department provides information technology and networking services and support, both within the Department and to other state agencies.
 - **Risk management and insurance**—The Department provides insurance coverage to state agencies and employees for property and liability losses through self-insurance and purchased insurance policies; and investigates, mitigates, and settles all property and liability claims against the State. It also self-insures and administers the State’s workers’ compensation benefits program.
 - **Vehicle fleet maintenance**—The Department manages the procurement, assignment, utilization, and maintenance of the State’s 1,767-vehicle fleet.
2. **The effectiveness with which the Department has met its objective and purpose and the efficiency with which it has operated.**

The Department is generally effective in meeting its overall objective and purpose and in operating efficiently. The Department provides centralized

programs and services that enable state agencies to share resources and avoid duplication such as procurement, accounting, travel reduction, telecommunications, and recruiting and hiring. The audits of the Financial Services Division, Human Resources Division, and Information Services Division and Telecommunications Program Office highlighted some ways in which the Department has operated efficiently:

- **The Financial Services Division audit** (see Auditor General Report No. 05-02, Finding 2) found that the Department and the state agency procurement community have designed a new model for state contracting that is expected to result in cost savings. Under this model, state agencies will purchase goods and services, such as janitorial supplies or financial services, collectively benefiting from the price discounts that result from higher purchase volumes. One state agency will serve as the strategic contracting center for the procurement of a particular good or service. The Department began implementing this model in 2005, and has estimated savings of \$29 million to \$34 million in fiscal year 2006 in state, federal, and other funds from using this procurement approach.
- **The Human Resources Division audit** (see Auditor General Report No.05-12, Other Pertinent Information) found that the Department expects to complete implementation of a new recruiting and hiring software program in November 2005, Yahoo!® Hiring Gateway (Hiring Gateway). Hiring Gateway provides a centralized Web-based process with several features and benefits that should simplify and expedite recruiting and hiring state-wide. Hiring Gateway includes a Web site, www.azstatejobs.gov, dedicated to posting state job announcements and accepting online applications from interested candidates, and it allows agencies to work online to develop job announcements, obtain necessary management approvals for job requisitions, create hiring lists, and send offer letters to prospective employees.

The Department's new procurement model is expected to result in cost savings.

However, the three audit reports also identified several ways in which the Department could improve its effectiveness and efficiency. For example:

- **The Financial Services Division audit** found that the Department should develop a plan for completing the Human Resources Information Solution (HRIS) system (see Auditor General Report No. 05-02, Finding 1). HRIS will provide a single integrated system to administer payroll, personnel, employee benefits, and other related functions. Phase 1 of the system, which processes state employee payroll, was implemented in December 2003. 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 the system. These functions include the Hiring Gateway 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.

However, 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**—The Department and its contractors expected to implement Phase 1 of the system by April 2003 and Phase 2 by July 2003. Amendments to the contract revised these dates—Phase 1 was changed to December 2003, and 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**—As of June 30, 2004, the Department reported that the project had consumed almost all of its \$42.5 million project funding, approximately \$6 million of which was used for project financing.¹ The personnel costs for continued HRIS development and implementation, as well as its operations, are now funded out of the Human Resources Division's budget at approximately \$2 million for fiscal year 2005.

According to state agency users, Phase 1 of the HRIS system does not provide all of the functionality they required or expected. Phase 2, which is expected to provide the major benefits of the new system, has yet to be fully implemented. As a result, agencies have not realized anticipated efficiency savings from HRIS. The Department should develop a plan for completing the system, specifying the remaining functions to be implemented, the staff resources needed, and a timeline to fully implement the system.

Additionally, the audit found that the Department can improve its workers' compensation claims process to help ensure that state employees who are injured while at work promptly receive benefits (see Auditor General Report No. 05-02, Finding 3). Although Risk Management meets the statutory time frame of 21 days for processing a claim, it may take much longer—weeks or even months—after the injury occurs for the injured employee to know whether a claim has been approved or denied. According to statute, injured state employees are responsible for filing a claim with the Industrial Commission of Arizona (Commission). Risk Management does not have to begin processing a claim until it is filed with the Commission. However, state employees may be unaware of the requirement, or some may rely on their physician to file an injury report with the Commission. Risk Management can prevent unnecessary workers' compensation benefit delays by improving communication with injured employees. 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

The Department needs a plan for completing HRIS.

¹ According to the Department, approximately \$2.3 million remains to pay for a planned upgrade to the system in fiscal year 2006 or 2007.

claim or the need to report claims to the Industrial Commission of Arizona. Adding this information could help injured employees receive benefits sooner.

- **The Information Services Division and Telecommunications Program Office audit** found that the Department does not perform regular monitoring and testing of its internal network and data center to identify and resolve these systems' potential vulnerabilities (see Auditor General Report No. 05-11, Finding 1). Additionally, the Department has not performed risk assessments to identify and evaluate the risks to the security of its information resources; developed comprehensive security policies and procedures; ensured corrective actions are implemented to address identified security weaknesses; and provided annual security awareness training to department employees.

The Division should establish a centralized and comprehensive security program to address these deficiencies and assign one of its positions the responsibility for administering the program. The Division should also determine if it needs additional staff, funding, and technical resources to adequately perform these security duties. If additional staff and resources are needed, the Department should then assess whether it could reassign existing staff and resources or take other steps, as appropriate, to seek additional staff and resources.

Additionally, the Department should seek statutory authority to enforce security requirements that state agencies must follow to use AZNET, the State's privatized telecommunications network, which is currently under development. The Department lacks the statutory authority to enforce security standards for information systems shared by state agencies. While the Government Information Technology Agency (GITA) has statutory authority to issue state-wide security standards, it lacks authority to enforce its standards, and its functions do not include the daily oversight of AZNET. However, if one state agency does not sufficiently secure its resources, it potentially exposes the other state agencies using a shared resource, such as AZNET, to an increased risk of data loss or hacker intrusion. With statutory authority, the Department can ensure that agencies using AZNET meet security standards, as defined by GITA, and any additional specific standards that the Department works with GITA to define.

Finally, the Department should improve its oversight of activities related to consolidating telecommunications support services and developing a single, privatized telecommunications network (see Auditor General Report No. 05-11, Finding 2). The Department needs to ensure there is an accurate inventory of the existing telecommunications equipment to determine each agency's telecommunications equipment needs and costs under the

contract, and to also identify costs for equipment upgrades. For example, the inventory will determine which of seven categories each of the State's approximately 40,000 phones falls under; the associated service costs for these phones can vary as much as \$40 per month, per phone. However, while a department official has indicated that two staff will be available to assist agencies, the Department has not dedicated any resources to oversee this process and instead plans to rely on state agencies' staff and the contractor to develop the inventory. To ensure an accurate inventory is conducted, the Department should reassign staff to oversee the inventory process or, if necessary, reallocate existing funding or take other steps, as appropriate, to hire a private contractor to oversee this process.

- **The Human Resources Division audit** found that the Department needs to re-examine several aspects of its management of the State's self-funded health benefits program (program), including determining what activities are most appropriate for its consultant to undertake (see Auditor General Report No. 05-12, Finding 1). To implement the program in the 4 months it had available, the Department relied heavily on help from a consultant. This short time frame also led to a larger-than-expected role for the consultant in overseeing the program. This heavy reliance on the consultant has required a significant amount of its fiscal year 2005 program administration budget and affected the Department's ability to hire staff and develop the necessary expertise to manage the program. However, now that the program is operational, the Department should determine the activities its consultants should perform and adopt a written policy that contains guidelines for their use.

The Department also should take steps to improve its oversight of its healthcare vendors by requiring the vendors to achieve additional standards for performance measures, developing quality-of-care performance measures, and developing a plan for conducting operational and financial reviews of its vendors. Finally, the Department also needs to assess its own staffing needs for overseeing the program. The Department has begun to develop a staffing plan for fiscal years 2007 and 2008 and should ensure that it includes the positions it needs, their duties, and an analysis of appropriate personnel costs.

Further, the Department should take some additional steps to enhance the long-term financial stability of the self-funded health benefits program by improving controls over healthcare claims payments (see Auditor General Report No. 05-12, Finding 2). The Department has contracted with four vendors to process and pay medical and prescription drug claims, and they have processed over \$262.9 million in claims payments between

The Department should take additional steps to enhance the long-term financial stability of the self-funded health benefits program.

October 1, 2004 and June 30, 2005. Independent annual audits of vendors' claims payment processes and controls, and claims payment data, as well as department tests to verify the accuracy of claims payments, would help ensure that the vendors are appropriately and accurately processing medical claims.

3. The extent to which the Department has operated within the public interest.

Although the Department's operations primarily affect state agencies and employees, some areas, such as personnel administration, public building maintenance, risk management, and procurement can indirectly impact the general public. For example:

- **The Financial Services Division audit** (see Auditor General Report No. 05-02) found that 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 is driven by an agency's historical loss trends and its exposure as it relates to a specific line of insurance coverage.
- **The Human Resources Division audit** (see Auditor General Report No. 05-12, Finding 2) found that the Department has established a funding reserve of approximately \$49.6 million as of June 30, 2005, to help lessen the State's risk for self-funding healthcare benefits. The Department has also purchased an insurance policy to limit the financial responsibility the State faces due to claims that exceed \$500,000 per insured individual. One concern associated with self-funded health insurance programs is the risk of catastrophic claims and the potential liability of paying for these claims. Insurance against such large claims reduces the financial risk of self-funding employee health benefits.
- The Department has implemented an employee wellness program, which includes health education, screenings, and an employee assistance program to improve state employees' health and well-being. Health education takes place through worksite classes on topics such as Blood Pressure Management and Weight Watchers® at Work. Worksite screenings include skin cancer and osteoporosis screenings. The Employee Assistance Program provides confidential, short-term counseling services and resource referrals to state employees and eligible family members.

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

Based on auditor review of applicable statute and corresponding administrative rules, as well as reviews performed by staff of the Governor's Regulatory Review Council (GRRC), the Department has adopted rules that, for the most part, appear consistent with the legislative mandate. While GRRC identified areas where the Department had not promulgated rules, it appears that the Department had addressed these requirements in a different manner. For example, GRRC noted that the Department has not adopted rules concerning state accounting requirements and procedures. However, the Department has instead adopted a *Statewide Accounting Manual*, which prescribes the accounting policies and procedures that state agencies must follow. According to A.R.S. §41-1005(A)(4), agencies are exempt from adopting rules if the rule concerns only the internal management of an agency that does not directly and substantially affect the procedural or substantive rights or duties of any segment of the public. Since the State's accounting policies and procedures do not affect the procedural or substantive rights or duties of the public, a rule is not required.

Additionally, the Department is revising and updating the State Procurement Code, A.A.C. R2-7-101 et seq. The proposed changes include modifications to Article 2, which provides specific guidance for the director to follow in hiring a state procurement administrator and lists duties of a state procurement administrator; Article 4, which details the manner in which specifications are prepared; and Article 10, which revises the process for approving specific materials and/or services for mandatory use. The Department estimates that a final rule package will be submitted to the Governor's Regulatory Rule Council for approval in early 2006.

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

The Department has encouraged input from stakeholders, other state agencies, and the public before adopting its rules. Specifically, for two of its most significant recent rule-making efforts, the Department reports using a variety of tools to solicit input from the public. For example, for its revision of the State Procurement Code, the Department established several specialized focus groups of minority- and women-run businesses, business associations, construction contractors and engineers, and technology firms to obtain feedback on proposed changes to the code. The Department met with each group, presented them with the proposed changes, and solicited comments. The Department also met with state agencies and political subdivisions to obtain comments. A committee consisting of procurement managers from several

state agencies used the feedback from the focus groups, state agencies, and political subdivisions and drafted proposed legislation and a rewrite of the rules. The draft rules were shared with state agencies and the focus group participants, and were posted on the Department's Web site to obtain further comments.

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

Statutes provide the Department with authority to address complaints within the following areas:

- **Procurement**—The Department has the authority to resolve bid protests according to A.R.S. §41-2501 et seq. Under this authority, the Department has adopted administrative rules that provide guidance for filing a protest, issuing a written decision, and appealing the decision. In remedying a protest, the Department can decline to exercise an option to renew under the contract, terminate the contract, amend the solicitation, issue a new solicitation, award a contract consistent with procurement statutes and regulations, or provide other relief as deemed necessary to ensure compliance with procurement statutes and regulations. According to a department official, the Department receives about 80 bid protests annually.
- **Personnel**—The Department also has the authority to resolve certain personnel-related issues according to A.R.S. §41-761 et seq. Under this authority, the Department has adopted administrative rules that provide guidance related to personnel matters and processes, such as making pay adjustments due to a manifest error, which is an act or failure to act that is, or clearly has caused, a mistake; resolving complaints about procedures used in the identification or selection of job candidates; and reviewing the classification of a position and grievances filed by employees. During 2004, the Human Resources Division received 34 personnel-related complaints that were filed through a formal process based on statutory authority.

In addition, some department divisions also handle and resolve complaints. For example:

- **The Department's Enterprise Procurement Services (EPS)** receives complaints from state agencies regarding vendor performance. One way in which EPS receives these complaints is via vendor performance reports, which are available on its Web site. While the Department has a written complaint procedure, it lacks detail guiding the procurement specialist through the process or the actions a specialist can take to resolve the

The Department should specify steps for investigating a vendor performance complaint.

complaint. In addition, the Department could not report on the number of vendor performance reports it receives, as it does not log these reports when they are received or track staff progress in investigating and resolving the complaint. Therefore, the Department should specify the steps a procurement specialist should take to investigate a complaint, as well as the criteria and factors that should be considered when determining an appropriate action to resolve the complaint. The Department should also create a log to record the receipt of vendor performance reports and to assist in tracking the progress of the complaint investigation.

- The Department helps to resolve employee appeals of department enrollment decisions and/or vendor medical service decisions regarding the State's self-funded health benefits program (see Auditor General Report No. 05-12, Finding 1). Between October 2004 and June 2005, the Department had received 350 appeals. The most common type of appeals involve the denial of a medical service, and of the 350 appeals received, 296 had been closed with the Department's help. A number of these appeals were resolved on the same day they were received, while only two appeals took more than 100 days to close.

However, the Department has not established written policies and procedures for its process. Therefore, the Department should establish policies and procedures documenting its appeals-handling process.

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

A.R.S. §41-192 authorizes the Attorney General's Office to serve as the legal advisor to the Department. For example, the Department handles reported liability claims internally and with the approval of the Attorney General. The Department approves settlements of reported liability claims up to \$100,000, and approves settlements in conjunction with the Attorney General for claims from \$100,000 to \$250,000.¹ The Attorney General's Office also provides legal services for the recovery of funds expended by the Department for losses for which other parties may be legally responsible.

In addition, the Attorney General's Office is the legal advisor for reported rule violations, such as reports of collusion or other anticompetitive practices that are suspected among bidders or offerors within the procurement process.

¹ Settlements in excess of \$250,000 are subject to Joint Legislative Budget Committee approval.

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

Several pieces of legislation affecting the Department's programs were enacted in the 2004 and 2005 regular legislative sessions:

- **Laws 2004, Chapter 190**—Amends the state procurement code, changing language regarding competitive sealed proposals to allow offerors to submit revisions to their offers if the original offer is determined by the procurement officer to be in the competitive range. This legislation also increases the threshold for competitive bids and proposals and allows the State to pay for a demonstration project if deemed in its best interest.
- **Laws 2004, Chapter 335**—Allows the Department to self-insure, or self-fund health insurance, and contract directly with provider organizations. The legislation requires the Department to designate and adopt performance standards for cost competitiveness, utilization review issues, network development and access, conversion and implementation, report timeliness, quality outcomes, and customer satisfaction.
- **Laws 2005, Chapter 162**—Amends the state procurement code, adding a section to allow the State to procure construction-manager-at-risk construction services and job-order-contracting construction services.¹ The legislation stipulates the process by which these contracts shall be procured, and states that a contract for construction services using the job-order-contracting method may be entered into for a period of up to 5 years.
- **Laws 2005, Chapter 301**—Requires the department director to establish a Telecommunications Program Office and enter into a contract with a business to provide for the installation and maintenance of telecommunications systems and act as the State's agent for telecommunications carrier services to the State's offices, departments, and agencies.

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

Based on audit work, the Department should ask the Legislature to amend §41-712 to grant the Department the authority to enforce the security requirements that state agencies must follow related to AZNET. While GITA was given statutory authority to issue state-wide security standards, it lacks authority to enforce these standards, and its functions do not include the daily oversight of AZNET. With this authority, the Department can ensure that agencies using AZNET meet

¹ Construction-manager-at-risk refers to a project delivery method in which there is a contract for construction services that is separate from the contract for design services. A job-order contract refers to a project delivery method in which the contract is for indefinite quantities of construction and, at the Department's election, may or may not include a guaranteed minimum amount of work.

security standards as defined by GITA and any additional specific standards the Department works with GITA to define (see Auditor General Report No. 05-11, Finding 1).

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

Terminating the Department could harm state employees' and, indirectly, the public's health, safety, and welfare due to the disruption of the many centralized services the Department provides. For example, state employees and vendors would not be paid, many of the State's buildings and grounds would not be cleaned or maintained, and the State would be without property, liability, and workers' compensation insurance. Further, while many of the Department's functions could be performed separately by each agency, it may not be efficient or cost-effective to operate in that manner.

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

Because the Department is not a regulatory agency, this factor is not applicable.

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

The Department uses private contractors to help it accomplish some of its duties. Specifically, the Department reported using private contractors for functions related to software development, disaster recovery, and custodial services. In addition, the Department has used private contractors for the following programs:

- **Human Resources Information Solution (HRIS)**—The Department hired a private contractor to help develop and implement this new system. HRIS replaced the State's Human Resources Management System, Benefits Information Tracking System, and other applications with a single integrated system to administer payroll, personnel, and employee benefits.
- **Telecommunications Program Office**—In January 2005, the Department signed a contract to consolidate management of all executive branch telecommunications services under a single contractor and to create a

state-wide voice and data network called AZNET used by executive branch agencies.

- **Risk Management**—The Department receives assistance from private contractors for actuarial services and to provide workers' compensation benefits to employees.
- **General Services Division**—The Department enters contracts with architects and engineers to design facilities and then hires construction companies to build the facilities. For example, in 2005 the Department awarded contracts to design and construct suicide prevention modifications to the Adobe Mountain Juvenile Institution in Phoenix; in 2004 to design and build three prison facilities housing 1,000 beds in Perryville, Tucson, and Douglas; and in 2002-2003 to design and build a National Guard Civil Support Team Ready Building in Phoenix.
- **Motor Pool**—The Department contracts with private vendors to provide passenger vehicle rentals and compressed natural gas capabilities at the Department's alternative fuels station. The Department uses a private rental car contractor to provide vehicles for business travel for state employees who work outside of Phoenix, and as a resource to obtain vehicles for business travel for employees in Phoenix if the Department's fleet does not have the needed vehicles available. The Department also contracted with a private vendor to design, construct, operate, and maintain a compressed natural gas vehicle fueling station at the Department's alternative fuel station located near the state capitol building in Phoenix.

Further, the Department contracts with health insurance providers and administrators to provide self-funded health insurance benefits to state employees, retirees, and their dependents, and a consultant to perform a variety of activities to manage and oversee the State's benefits program. To better manage the program, the Department should more clearly define the role of its consultant and increase its oversight of the consultant's activities. Please see Finding 1 of the Human Resources Division Audit (Auditor General Report No. 05-12) for further information on the recommendations pertaining to contractors' roles in the State's self-funded health benefits program.

Audit work did not identify other uses for private contractors by the Department.

AGENCY RESPONSE



Janet Napolitano
Governor

Jerry A. Oliver, Sr.
Interim Director

ARIZONA DEPARTMENT OF ADMINISTRATION

OFFICE OF THE DIRECTOR

100 North 15th Avenue • ROOM 401
PHOENIX, ARIZONA 85007

(602) 542-1500

September 21, 2005

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

Dear Ms. Davenport:

On behalf of the entire department, I wish to thank you for your staff's hard work and dedication during the sunset audit of the Department of Administration. These audits were an excellent opportunity for this department to receive objective, in-depth scrutiny of our performance. Your extensive efforts will yield valuable improvements in our operations as we implement your recommendations.

Sincerely,

Jerry A. Oliver
Interim Director

ADOA Agency Response, by Section and Finding

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

Recommendations:

Recommendation – EPS (page 16): *The Department should specify the steps a procurement specialist should take to investigate a complaint, as well as the criteria and factors that should be considered when determining an appropriate action to resolve the complaint.*

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

Recommendation – EPS (page 16): *The Department should also create a log to record the receipt of vendor performance reports and to assist in tracking the progress of the complaint investigation.*

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

04-L1	Letter Report—Arizona Medical Board	05-L1	Letter Report—Department of Health Services—Ultrasound Reviews
04-L2	Letter Report—Gila County Transportation Excise Tax	05-01	Department of Economic Security—Division of Employment and Rehabilitation Services—Unemployment Insurance Program
04-L3	Letter Report—Department of Economic Security—Population Estimates	05-02	Department of Administration—Financial Services Division
04-01	Arizona Tourism and Sports Authority	05-03	Government Information Technology Agency (GITA) & Information Technology Authorization Committee (ITAC)
04-02	Department of Economic Security—Welfare Programs	05-04	Department of Economic Security—Information Security
04-03	Behavioral Health Services' HB2003 Funding for Adults with Serious Mental Illness	05-05	Department of Economic Security—Service Integration Initiative
04-04	Department of Emergency and Military Affairs and State Emergency Council	05-06	Department of Revenue—Audit Division
04-05	Department of Environmental Quality—Water Quality Division	05-07	Department of Economic Security—Division of Developmental Disabilities
04-06	Department of Environmental Quality—Waste Programs Division	05-08	Department of Economic Security—Sunset Factors
04-07	Department of Environmental Quality—Air Quality Division	05-09	Arizona State Retirement System
04-08	Department of Environmental Quality—Sunset Factors	05-10	Foster Care Review Board
04-09	Arizona Department of Transportation, Motor Vehicle Division— State Revenue Collection Functions	05-11	Department of Administration—Information Services Division and Telecommunications Program Office
04-10	Arizona Department of Transportation, Motor Vehicle Division—Information Security and E-government Services	05-12	Department of Administration—Human Resources Division
04-11	Arizona Department of Transportation, Motor Vehicle Division—Sunset Factors		
04-12	Board of Examiners of Nursing Care Institution Administrators and Assisted Living Facility Managers		

Future Performance Audit Division reports

Department of Revenue—Collections Division

Department of Revenue—Business Reengineering Integrated Tax System (BRITS)