



DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

February 2, 2018

The Honorable Anthony Kern, Chair
Joint Legislative Audit Committee

The Honorable Bob Worsley, Vice Chair
Joint Legislative Audit Committee

Dear Representative Kern and Senator Worsley:

Our Office has recently completed a 36-month followup of the Arizona Department of Administration—Arizona State Purchasing Cooperative Program regarding the implementation status of the 19 audit recommendations (including sub-parts of the recommendations) presented in the performance audit report released in November 2014 (Auditor General Report No. 14-108). As the attached grid indicates:

- 3 have been implemented;
- 1 has been partially implemented;
- 6 are in the process of being implemented; and
- 9 have not been implemented.

Given the status of the Arizona Department of Administration's efforts to implement the report's recommendations, we believe that additional followup would be of limited value. Therefore, unless otherwise directed by the Joint Legislative Audit Committee, this concludes our follow-up work on the Department's efforts to implement the recommendations from the November 2014 performance audit report.

Sincerely,

Dale Chapman, Director
Performance Audit Division

DC:ka
Attachment

cc: Gilbert Davidson, Interim Director
Arizona Department of Administration

Kevin Donnellan, Deputy Director
Arizona Department of Administration

**Arizona Department of Administration—
Arizona State Purchasing Cooperative Program
Auditor General Report No. 14-108
36-Month Follow-Up Report**

Recommendation

Status/Additional Explanation

Finding 1: Program fee revenue exceeds program costs and is misapplied

1.1 To ensure its program fee better aligns with its costs to administer the purchasing cooperative program, the Department should implement a structured approach to evaluate its program fee. Specifically, the Department should do the following:

- a. Assess the efficiency of its purchasing cooperative program operations to ensure costs are as low as possible while considering service quality, and document the results of its assessment. As the Department assesses the efficiency of its operations, it should seek to minimize costs where possible.

At the time of the initial followup issued in March 2016, the Department had begun taking action to align its purchasing cooperative fee with its costs to administer the program. However, as of this followup, other than undertaking some program improvements, the Department has stopped implementing the recommendations in Finding 1. Instead, it reported that it is actively exploring a new funding model that would use purchasing cooperative fee revenues to cover not just the program's costs, but all the procurement office's operating costs because it believes that virtually all procurement office activities support the purchasing cooperative program by improving state-wide contracts for use by cooperative members and state agencies.

Partially implemented at 36 months

Although the Department did not assess the efficiency of its purchasing cooperative program operations to ensure costs are as low as possible while considering service quality, it did implement various program efficiencies as part of an improvement project. This improvement project focused on developing an automated work process for managing the purchasing cooperative program to ensure that program contract vendors are reporting purchasing cooperative member use of their contracts and remitting the required program fee. For example, the Department developed and implemented a new report format that enhanced the accuracy and consistency of vendor-reported usage and program fee information using drop-down boxes, uniform naming conventions, and automatic calculation fields. This action simplified the process for vendors to provide required information on the amount of purchases made by purchasing cooperative members and the fee amount the vendor is required to remit to the program, and reduced the time department staff must spend following up on errors due to inaccurate or incomplete information. In January 2018, the Department implemented an online system for vendors to directly report usage and submit their fees, further streamlining its processes.

Recommendation

Status/Additional Explanation

- b. Develop and implement a method for determining purchasing cooperative program costs, including both direct and indirect costs, and create policies and procedures for using this method.
- Not implemented**
As indicated in the initial followup issued in March 2016, this recommendation was listed as implemented because the Department contracted for and was provided a cost allocation methodology for the purchasing cooperative program in October 2015. The methodology identified direct and indirect costs and included policies and procedures for using the cost allocation method. However, the Department's current procurement office management reported that they were unaware of the cost allocation method, and the associated policies and procedures, and has not implemented them.
- c. Establish a cost allocation methodology for tracking and allocating the direct and indirect costs for operating the purchasing cooperative program.
- Not implemented**
See explanation for Recommendation 1.1b. In addition, although procurement office management reported that more than half of its operating costs are attributable to the purchasing cooperative program, it did not provide a cost allocation analysis to support this statement.
- d. After the method is developed and costs are appropriately tracked, the Department should use the costs to analyze its program fee structure, determine the appropriate program fee to charge, and set it accordingly.
- Not implemented**
Because the Department has not developed a method for determining purchasing cooperative program costs or tracked these costs (see explanation for Recommendations 1.1b and 1.1c), it lacks the information needed to analyze its program fee structure, determine the appropriate program fee to charge, and set it accordingly. In addition, procurement office management reported that because virtually everything the procurement office does supports the purchasing cooperative program by improving state-wide contracts for use by cooperative members and state agencies, the Department is actively exploring a new funding model that would use purchasing cooperative fee revenues to cover all procurement office operating costs.
- e. Develop and implement formal fee-setting policies and procedures that require a periodic review of the purchasing cooperative program's costs and fee.
- Not implemented**
The Department has not established formal fee-setting policies and procedures that require a periodic review of the purchasing cooperative program's costs and fee. As noted in the explanation for Recommendation 1.1d, the Department has not developed and implemented a fee-setting process. According to the Department, fee adjustments would occur through the budget process. Specifically, insufficient funding for the purchasing cooperative program would result in increasing the fee, while excess fee collections could potentially be used to reduce the purchasing cooperative program's State General Fund appropriations.

Recommendation

Status/Additional Explanation

- f. Consider the effect that proposed program fee changes may have on purchasing cooperative members and obtain their input when reviewing and revising the program fee.

Not implemented

The Department does not see the need to consider the effect that proposed program fee changes may have on purchasing cooperative members and obtain their input. It believes that there is an inherent policing mechanism if fee changes occur. For example, cooperative members can choose not to use the state-wide contracts if the costs of the goods and services are too high, which may impact vendors' decisions on whether to adjust their prices to reflect fee increases.

Finding 2: Department needs to improve collection of program fee revenue

- 2.1 The Department should pursue collection of any unpaid program fee revenue payments, including those identified in this audit, and resolve any discrepancies between vendor-reported sales amounts and state accounting records.

Implementation in process

The Department has begun developing and implementing processes to help it pursue collection of unpaid program fee revenue and resolve discrepancies between vendor-reported sales amounts and state accounting records. Specifically, the Department revised its purchasing cooperative database and developed queries to more systematically identify missing fee payments and discrepancies between vendor-reported sales amounts and state accounting records. In addition, it has established an improvement project to recover past-due program fee revenue payments totaling approximately \$384,000 that it identified from its review of fiscal years 2014 through 2016 usage reports.

- 2.2 The Department should develop and implement program fee collections policies and procedures that:

- a. Ensure program fee rates are accurately documented and communicated between staff establishing the program fee and staff responsible for collecting the program fee revenue;

Not implemented

In lieu of policies and procedures, the Department has developed high-level standardized work flows to document some of the activities performed by purchasing cooperative program staff. However, these work flows do not address ensuring that program fee rates are accurately documented and communicating program fee information between staff establishing the program fee and staff responsible for collecting program fee revenue.

- b. Verify vendor-reported sales and program fee revenue amounts to help ensure these amounts are properly reported and all program fee revenue is remitted to the Department;

Not implemented

In lieu of policies and procedures, the Department has developed high-level standardized work flows to document some of the activities performed by purchasing cooperative program staff. However, these work flows do not address verifying vendor-reported sales and program fee revenue amounts and that all program fee revenue is remitted to the Department.

Recommendation

Status/Additional Explanation

c. Formalize its 30-day notification process and require department staff to follow up on delinquent and/or deficient reports and program fee revenue payments. The policies and procedures should address the timing, form, and content of department communications with vendors to address deficient and/or delinquent reports and program fee revenue payments; and

Implementation in process

The Department developed processes for notifying vendors that their required quarterly report and program fee revenue payments are coming due and to guide department staff in following up on delinquent and/or deficient program reports and fee revenue payments. Specifically, the Department incorporated the 30-day notice into the invoice statement it sends to the vendors at the end of each quarterly billing period. It also developed a process to follow up on deficient and/or delinquent reports and program fee revenue payments, which according to the Department, was implemented in January 2018. The process requires program staff to send, at specified points in time, reminder emails to vendors who fail to submit their program fees and/or reports. Although the process addresses timelines and how vendors will be informed, it does not indicate what the reminder email content should include. Further, neither the notification nor the follow-up process has been formalized in policy and procedure or high-level standardized work flows.

d. Guide staff on specific measures to take when enforcing reporting and program fee requirements on noncompliant vendors using any recourse available under the state-wide contract or law.

Not implemented

In lieu of policies and procedures, the Department has developed high-level standardized work flows to document some of the activities performed by purchasing cooperative program staff. However, these work flows do not guide staff on specific measures to take when enforcing reporting and program fee requirements on noncompliant vendors.

2.3 As part of its collections policies and procedures, the Department should include provisions requiring supervisory oversight of its collections processes and practices.

Not implemented

In lieu of policies and procedures, the Department has developed high-level standardized work flows to document some of the activities performed by purchasing cooperative program staff. However, these work flows do not include provisions requiring supervisory oversight of its collections processes and practices.

2.4 The Department should ensure that its staff are trained on the collections policies and procedures.

Implementation in process

Although as of the initial followup issued in March 2016 the Department had developed draft collections policies and procedures, as indicated in the explanations for Recommendations 2.2a through 2.2d, most have not been finalized. The Department has only provided on-the-job training for staff on the 30-day notification process, which staff have been implementing since July 2017.

Recommendation**Status/Additional Explanation****Finding 3: Department should continue to improve its controls over program fee collections**

3.1 The Department should continue to implement the changes it has made to help ensure that program fee revenue payments are protected and accurately recorded and deposited, including:

a. Transferring all cash-handling responsibilities from the Department's procurement office to its accounting office;

Implemented at 12 months

b. Ensuring that vendors remit program fee revenue payments to the accounting office; and

Implemented at 12 months

c. Immediately restrictively endorsing, logging, and depositing all program fee revenue payments.

Implemented at 12 months

3.2 The Department should develop and implement detailed policies and procedures that address all accounting and cash-handling functions including segregation of duties, required endorsements, logs and receipts, and performing reconciliations.

Implementation in process

As indicated in the initial follow-up report issued in March 2016, program fee payments are now processed by the Department's accounting office staff, who follow cash-handling policies and procedures specified in the *State of Arizona Accounting Manual*. The Department developed draft cash-handling policies and procedures for program staff who handle program fee revenue payments mistakenly sent to the procurement office, but has not yet finalized them. The Department has also developed a reconciliation process to ensure all program fee revenue payments the accounting office receives are reconciled to vendor-reported sales that program staff track. However, it has not formalized this process in policies and procedures. The Department indicated that it plans to formalize these processes in detailed policies and procedures by March 2018.

3.3 The Department should distribute the detailed policies and procedures to all applicable staff and provide training on them as appropriate to staff's assigned duties.

Implementation in process

Although the Department's accounting office staff have access to and have been trained on cash-handling policies and procedures specified in the *State of Arizona Accounting Manual*, as explained in Recommendation 3.2, the Department has yet to finalize cash-handling policies and procedures for program fee revenue payments mistakenly sent to the procurement office and its process for reconciling these payments and vendor-reported sales. Thus, appropriate staff have not been trained on these policies and procedures.

Recommendation

Status/Additional Explanation

3.4 The Department should monitor staff's implementation of the policies and procedures to ensure they are being appropriately followed.

Implementation in process

The Department's accounting office supervisors monitor staff's implementation of cash-handling policies and procedures specified in the *State of Arizona Accounting Manual*. However, as explained in Recommendation 3.2, the Department has yet to finalize its cash-handling policies and procedures for program fee revenue payments mistakenly sent to the procurement office and its process for reconciling these payments and vendor-reported sales. Monitoring cannot occur until these policies and procedures have been finalized and implemented.
