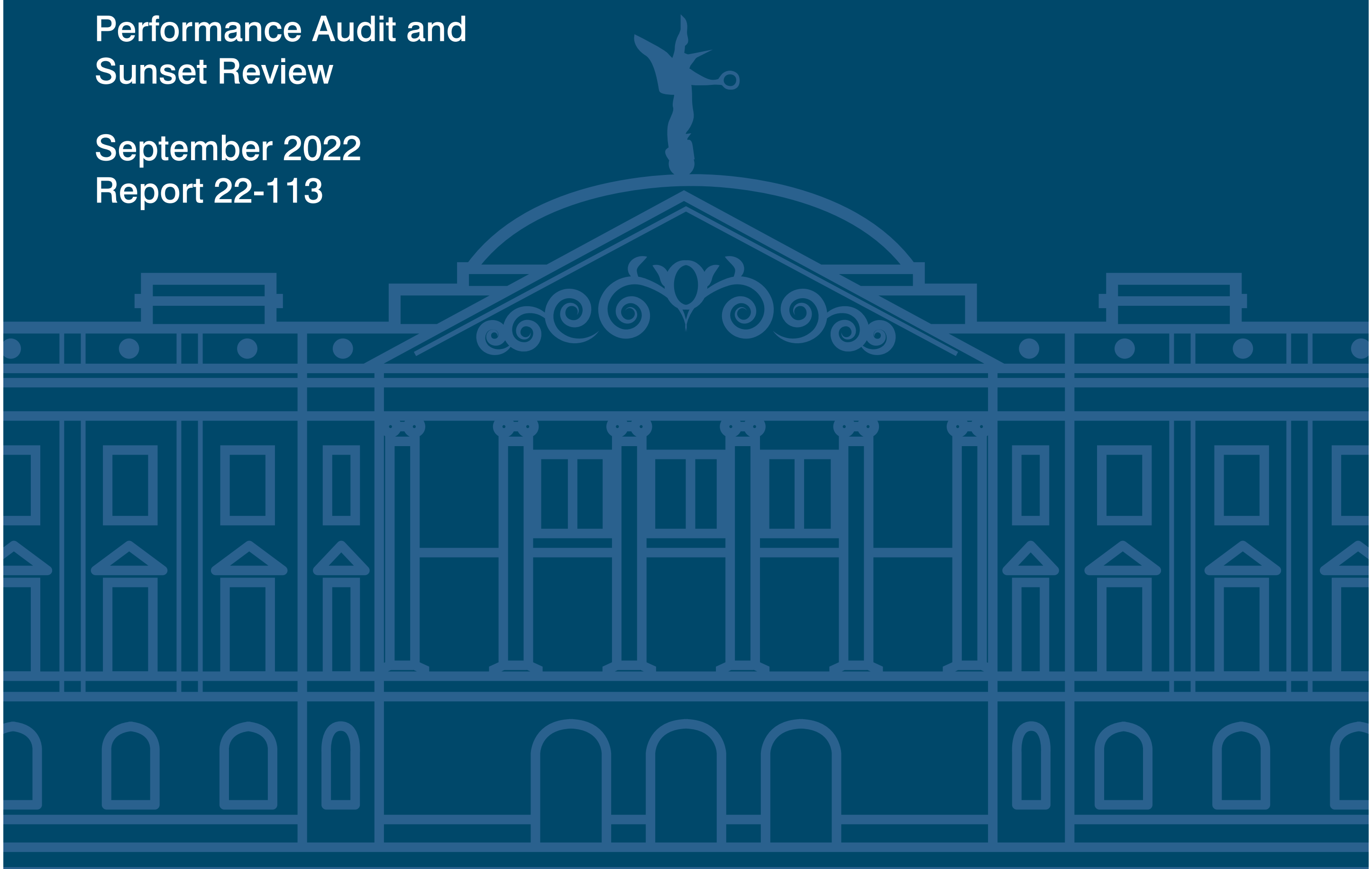
Arizona Office of Economic Opportunity

Office provides economic, demographic, and tax research and analysis for the State but lacked documentation of benefits received for payments made to Commerce Authority, and Arizona Finance Authority, a related entity, lacked oversight controls for some key activities increasing risk for errors and fraud

Performance Audit and
Sunset Review

September 2022
Report 22-113



A Report to the Arizona Legislature

Lindsey A. Perry
Auditor General

ARIZONA
AuditorGeneral
Making a Positive Difference

The Arizona Auditor General's mission is to provide independent and impartial information and specific recommendations to improve the operations of State and local government entities. To this end, the Office provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits and special reviews of school districts, State agencies, and the programs they administer.

The Joint Legislative Audit Committee

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September 30, 2022

Members of the Arizona Legislature

The Honorable Doug Ducey, Governor

Ms. Sandra Watson, Director
Arizona Office of Economic Opportunity

Mr. Dirk Swift, Executive Director
Arizona Finance Authority

Transmitted herewith is the Auditor General's report, *A Performance Audit and Sunset Review of the Arizona Office of Economic Opportunity*. This report is in response to a December 17, 2020, 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 within this report a copy of the Report Highlights to provide a quick summary for your convenience.

As outlined in their responses, the Arizona Office of Economic Opportunity and the Arizona Finance Authority Board of Directors each agree with the findings directed to them and plan to implement all their respective recommendations. My Office will follow up with the Arizona Office of Economic Opportunity and the Arizona Finance Authority in 6 months to assess their progress in implementing the recommendations.

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

Sincerely,

Lindsey A. Perry

Lindsey A. Perry, CPA, CFE
Auditor General

cc: Arizona Finance Authority Board of Directors members

Report Highlights

Arizona Auditor General
Making a positive difference

Arizona Office of Economic Opportunity

Office provides economic, demographic, and tax research and analysis for the State but lacked documentation of benefits received for payments made to Commerce Authority, and Arizona Finance Authority, a related entity, lacked oversight controls for some key activities increasing risk for errors and fraud

Audit purpose

To determine if the Office complied with applicable requirements related to its expenditures and if the Arizona Finance Authority (AFA), which statute established within the Office, implemented oversight controls for the Arizona Industrial Development Authority (AIDA), and provide information related to the AIDA's conduit bond program and responses to the statutory sunset factors.

Key findings

- The Office was established in 2016 to consolidate and improve analytic capacity for the State by providing economic, demographic, regulatory, and tax research and analysis. The laws establishing the Office also established the AFA within the Office and required the AFA Board of Directors to serve as the board for the AIDA.
- The Office uses various processes to help meet its statutory objectives and purposes including monitoring the State's tax and regulatory competitiveness, collecting and analyzing information included in the State's workforce plan, and producing annual population estimates for the State.
- The Office lacked evidence to demonstrate the benefits it received in exchange for more than $260,000 it annually paid to the Arizona Commerce Authority for administrative and technical services in fiscal years 2020 through 2022 and the Office allocated some of these costs to federal programs potentially inconsistent with federal requirements.
- The AFA Board had not implemented internal controls for managing and overseeing some AIDA activities, such as its conduit bond program which issued approximately $2 billion in conduit bonds in fiscal year 2022, resulting in increased risk for errors and fraud.
- The AIDA's costs to operate its conduit bond program in fiscal year 2021 were at least 70 percent higher than 3 other conduit issuer entities we reviewed.

Key recommendations

The Office should:

- Develop and implement processes to ensure the benefits and services the Arizona Commerce Authority provides to the Office are commensurate with the costs it pays the Arizona Commerce Authority.
- Ensure it complies with federal requirements for allocating costs to federal programs.

The AFA Board should:

- Ensure the AIDA Board of Directors develops and implements a comprehensive system of internal controls for the AIDA's activities.
- Ensure the AIDA conducts an analysis of the conduit bond program's operational costs to identify potential cost savings.

See Performance Audit and Sunset Review Report 22-113, September 2022, at www.azauditor.gov.

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INTRODUCTION

The Arizona Auditor General has completed a performance audit and sunset review of the Arizona Office of Economic Opportunity (Office). This performance audit and sunset review determined whether the Office complied with applicable requirements related to its expenditures and State conflict-of-interest laws, and whether the Arizona Finance Authority (AFA) complied with statutory and other State requirements related to the Arizona Industrial Development Authority (AIDA). This report also provides information related to the conduit revenue bond program operated by the AIDA and responses to the statutory sunset factors.

Office history, mission, and responsibilities

Laws 2016, Ch. 372, §52, established the Office to consolidate and improve analytic capacity for the State by providing economic, demographic, regulatory, and tax research and analysis. These laws also established the AFA in the Office, required the AFA to establish the AIDA, and required the AFA Board of Directors (AFA Board) to serve as the board for the AIDA, the Water Infrastructure Finance Authority, and the Greater Arizona Development Authority (see pages 4 through 6 for more information on the AFA, AFA Board, and AIDA).[1] However, Laws 2022, Ch. 366, removed the Water Infrastructure Finance Authority from the Office, established the Water Infrastructure Finance Authority Board, and transferred responsibility for overseeing the Water Infrastructure Finance Authority from the AFA Board to the Water Infrastructure Finance Authority Board, effective September 24, 2022. As a result, the AFA Board no longer serves as the board for the Water Infrastructure Finance Authority.[2,3] See Figure 1, page 2, for information about the Office's organizational structure.

Office's mission

To improve the workforce and business climate in Arizona through data-driven policy making and effective workforce and economic development initiatives.

Source: The Office of Strategic Planning and Budgeting's *Master List of State Government Programs*.

Laws 2016, Ch. 372, §55, also established the Workforce Data Task Force in the Office to oversee data sharing between State agencies for the purpose of developing and maintaining the State's workforce evaluation data system.

The Office has a Governor-appointed Director who, as of August 2022, concurrently serves as the President and Chief Executive Officer (CEO) of the Arizona Commerce Authority (Commerce Authority). Additionally, pursuant to an interagency service agreement, Commerce Authority executives oversee various Office functions (see pages 7 through 8) but do not oversee any functions related to the AFA. The Office pays the Commerce Authority for a portion of these executives' salaries and employment-related expenses (see Finding 2, pages 16

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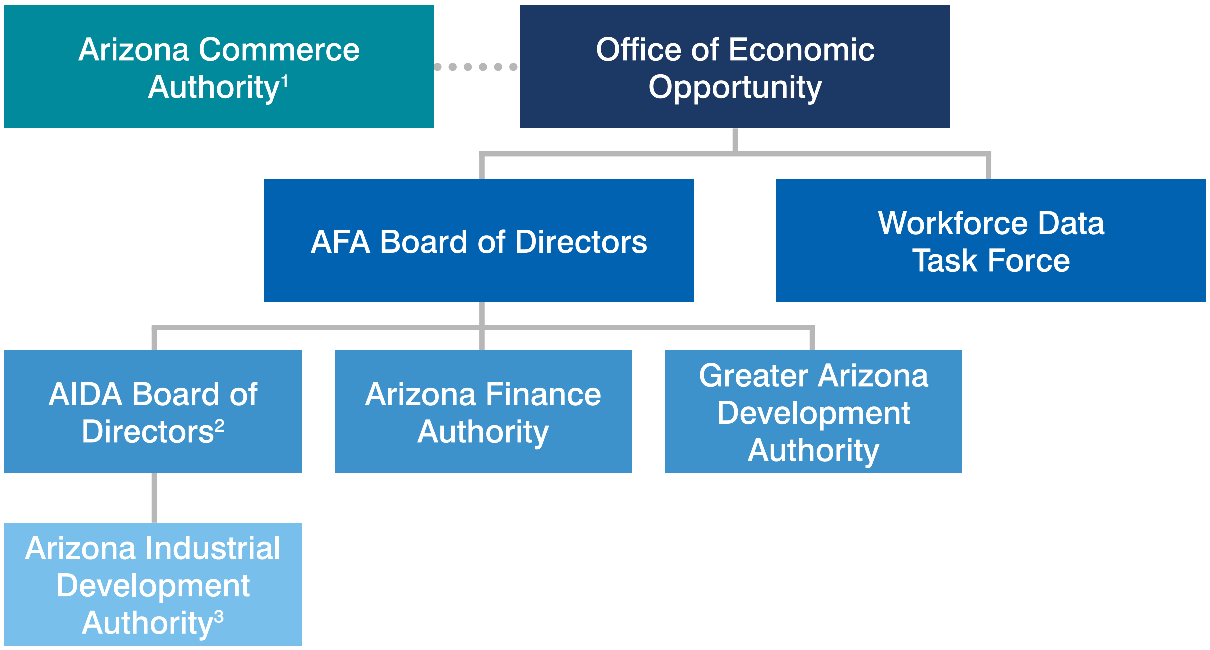
1 Laws 2016, Ch. 372, §75, also terminated and transferred the responsibilities and obligations of several State entities to the AIDA, including the Arizona Health Facilities Authority; the Arizona Housing Finance Authority, which was supported by the Arizona Department of Housing; and the Arizona International Development Authority, which was supported by the Arizona Department of Transportation.

2 Prior to these changes, the Water Infrastructure Finance Authority had a separate termination date from the Office, and we conducted a performance audit and sunset review of the Water Infrastructure Finance Authority that was issued in September 2021. See Arizona Auditor General report 21-115 *Water Infrastructure Finance Authority of Arizona* for additional information.

3 Pursuant to statute, the AFA Board established the Water Infrastructure Finance Authority advisory board. Laws 2022, Ch. 366, terminated this advisory board, established the Federal Water Programs Committee to advise the new Water Infrastructure Finance Authority Board, and included a provision allowing members of the terminated advisory board to continue serving on the Federal Water Programs Committee until their terms expire.

through 18, for more information about the Office's payments to the Commerce Authority). Commerce Authority leadership reported that the Office and the Commerce Authority have integrated their operations to create various efficiencies and cost savings (see Finding 2, pages 17 through 18, for more information about the relationship between the Office and the Commerce Authority).[4]

Figure 1
Office's organizational structure



1 The Office has a Governor-appointed Director who, as of August 2022, concurrently serves as the President and CEO of the Commerce Authority. Pursuant to an interagency service agreement, Commerce Authority executives oversee various Office functions but do not oversee any functions related to the AFA. The Office pays the Commerce Authority for a portion of these executives' salaries and employment-related expenses. Commerce Authority leadership reported that the Office and the Commerce Authority have integrated their operations.

2 According to A.R.S. §§41-5356(A)(1) and 35-705, the AFA Board is statutorily required to serve as the board for the AIDA. The AIDA's corporate bylaws establish the AIDA Board of Directors and specify that it shall comprise the same members as the AFA Board of Directors.

3 The AIDA is a nonprofit corporation and political subdivision of the State.

Source: Auditor General staff review of Office documents and Arizona Revised Statutes (A.R.S.) §41-5301 et seq.

The Office's responsibilities include:

- **Serving as the State's workforce planning coordinator and providing labor market information—** Statute requires the Office to provide staffing support to the Workforce Arizona Council and serve as the State's workforce planning coordinator.[5] Pursuant to these requirements, the Office works with local area workforce development boards to develop local workforce plans and assists the Workforce Arizona Council in developing the State-wide workforce plan.[6] Additionally, pursuant to an interagency service agreement

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4 The Office's enabling statutes do not establish a formal relationship between the Office and the Commerce Authority except that A.R.S. §41-5303 requires the Office to provide the Commerce Authority with analytical support for its State marketing and business recruitment, growth, and retention strategies.

5 A.R.S. §41-5303(A)(2).

6 The Workforce Arizona Council is established by A.R.S. §41-5401, as required by 29 United States Code (U.S.C.) §3111 of the Workforce Innovation and Opportunity Act (WIOA). It is statutorily responsible for advising the Governor on State-wide workforce development strategy and policy and providing State-level coordination of workforce development policies and programs. Additionally, Arizona has 12 local area workforce development boards that represent cities, counties, and/or regions in the State and are responsible for ensuring that workforce development efforts align with the local areas' workforce needs.

with the Arizona Department of Economic Security (Department of Economic Security) and guidance from the U.S. Department of Labor's Bureau of Labor Statistics (Bureau), the Office administers several labor market-related data-collection programs, including:

- **Quarterly Census of Employment and Wages—**Collects and reports quarterly to the Bureau information about employment and wage data by Arizona county, including monthly employment figures, total quarterly wages, and the average weekly wage for 20 employment sectors defined by the U.S. Census Bureau.[7] The Bureau requires the Office to publish quarterly, for public use, aggregate data that this program collects.
- **Occupational Employment and Wage Statistics—**Collects and reports semiannually to the Bureau information from a survey of employers about the number of workers and wage ranges by occupation in nonagricultural industries in the State.
- **Local Area Unemployment Statistics—**Collects and reports monthly to the Bureau employment information for local areas in the State, including total employment numbers, labor force participation, and the number and rate of unemployment.[8]
- **Current Employment Statistics—**Collects and reports monthly to the Bureau information such as employment estimates, average weekly and hourly earnings, and average hours worked in nonagricultural industries based on payroll records.

- **Producing a list of approved career and technical education programs—**Laws 2021, Ch. 404, requires the Office, in collaboration with the Arizona Department of Education, to produce by September 1 each year a regional list of approved career and technical education (CTE) programs that lead to a career path in high-demand occupations.[9] The Office is required to incorporate industry feedback as part of developing this list, and during the audit, it reported that it was in the process of developing and implementing a business engagement survey to meet this requirement. The Office reported that it planned to publish the list of approved CTE programs on its website after the list is approved by the Arizona Department of Education.
- **Developing and maintaining a State workforce evaluation data system—**The Workforce Data Task Force is responsible for overseeing data sharing between State agencies for the purpose of developing and maintaining the State workforce evaluation data system (data system).[10] The data system is an information technology (IT) system intended to compile data from various State agencies and educational institutions to allow analysis of how these agencies and educational institutions affect the lives of Arizonans over a period of time. Specifically, the system is intended to collect data from various governmental entities, such as the Department of Economic Security and community colleges within the State, to understand how individuals are affected by these entities and refine government efforts to generate better outcomes for Arizona citizens. The Office has worked with the Workforce Data Task Force to develop the data system, including signing data sharing agreements with other agencies responsible for transmitting data to the data system and contracting with IT vendors to develop and implement the data system (see Sunset Factors, page 23, for more information about the data system).
- **Producing State, county, and municipality population estimates—**Statute requires the Office to provide demographic research and analysis, including producing constitutionally required population

7 The U.S. Census Bureau's North American Industry Classification System (NAICS) is the standard used by federal agencies in classifying business establishments for the purposes of collecting, analyzing, and publishing statistical data related to the U.S. business economy. NAICS includes 20 business sectors, such as construction, manufacturing, retail trade, finance and insurance, and educational services.

8 According to the Bureau, local areas include various geographical units such as states, counties, and county equivalents, census regions and divisions, and metropolitan statistical areas.

9 This law became effective on September 29, 2021.

10 A.R.S. §41-5404.

estimates for the State.[11] The Office includes the Office of the State Demographer (Demographer's Office) that, pursuant to an interagency service agreement with the Department of Economic Security, is responsible for producing these official population estimates for the State. Population estimates for the State and each county, city, and town within the State produced by the Demographer's Office are statutorily required to be delivered to the Arizona Department of Revenue's Economic Estimates Commission before December 15 each year.[12] Additionally, the population estimates are published on the Commerce Authority website annually by December 15. As of July 2022, the most recent estimates on the Commerce Authority's website were population estimates for July 1, 2021.

- **Monitoring the State's tax and regulatory competitiveness—**The Office is statutorily required to monitor the State's tax and regulatory competitiveness by comparing the State's tax and regulatory environment to competitor states and municipalities.[13] Pursuant to this requirement, the Office provides financial support to the Commerce Authority to identify competitor states and municipalities based on various factors such as geography, key industries in the State's economic development strategy, and migration trends. The Commerce Authority uses these competitors to evaluate Arizona's tax and regulatory competitiveness. For example, in October 2020, the Office signed an interagency service agreement to reimburse the Commerce Authority for a contracted study of the State's tax competitiveness as compared to 165 communities located in the other 49 U.S. states. This study compared total tax obligations for various hypothetical businesses and individuals, such as a large aerospace manufacturer or a married couple earning $70,000 annually in these communities. The study considered various tax types such as personal and corporate income taxes, real and personal property taxes, and sales taxes in its estimates.

  Additionally, the Office publishes information on the Commerce Authority website about the State's regulatory competitiveness, such as the total word count and total restrictive word count in the Arizona Administrative Code, the number of rules revised or eliminated each year, and the estimated annual savings from revised or eliminated rules.[14]

AFA mission and responsibilities

As previously discussed, statute establishes the AFA within the Office. Additionally, according to A.R.S. §41-5353, the AFA is required to be governed by a board of directors consisting of 5 Governor-appointed members (see pages 7 through 8 for more information on the composition of the AFA Board). Statute requires the AFA Board to serve as the board of the Greater Arizona Development Authority.

AFA's mission

The AFA is a one-stop resource for financing, supporting, expanding, and relocating businesses, communities' infrastructure needs, and first-time homebuyers. The AFA is committed to providing a streamlined, predictable process to help homebuyers receive affordable financing.

Source: The Office of Strategic Planning and Budgeting's *Master List of State Government Programs*.

Additionally, A.R.S. §41-5356(A)(1) required the AFA Board to establish the AIDA. Statute also requires industrial development authorities in the

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[11] Arizona Constitution Art. IX, §20 and A.R.S. §41-1954 require the Department of Economic Security to produce an annual estimate of the population for the State and each county, city, and town within the State. The Department of Economic Security has delegated its responsibilities for producing these required population estimates to the Office through an interagency service agreement. Additionally, A.R.S. §§41-5303(A)(2) and 41-5402(A)(1) require the Office to provide economic and demographic research and analysis, including constitutionally required population estimates.

[12] A.R.S. §41-1954(A)(14). The Economic Estimates Commission is responsible for calculating the expenditure limits for Arizona counties, cities towns, and community colleges, as well as the aggregate expenditure limitation for all Arizona public school districts; estimating Arizona's personal income and the change in per capita personal income each fiscal year; and determining the maximum amount expected to be available for legislative appropriations from State tax revenues.

[13] A.R.S. §41-5303(A)(1).

[14] The total restrictive word count is the total count of each instance of the words or phrases "shall," "must," "required," "may not," and "prohibited" in the Arizona Administrative Code.

State, including the AIDA, be established as nonprofit corporations and political subdivisions of the State. Further, A.R.S. §35-701(2)(c) designated the AFA Board of Directors as the governing body for the AIDA.[15] Pursuant to these requirements, in August 2016, the AFA Board passed a resolution authorizing the AIDA to be established and in that same month, the AIDA filed legal incorporation documents with the Arizona Corporation Commission. The AIDA's articles of incorporation indicate that it was formed to promote industry, develop trade, and provide financial and other types of assistance in the rehabilitation, expansion, and development of commercial enterprises. Additionally, the AIDA's incorporation documents indicate that the AIDA performs essential government functions, and its activities should serve public purposes and be in furtherance of the health, safety, and welfare of Arizona residents.

A.R.S. §§35-705 and 41-5356(A)(1) also require the AFA Board to serve as the board for the AIDA. Consistent with this requirement, the AIDA's corporate bylaws established the AIDA Board of Directors comprising the members of the AFA Board (see Finding 1, pages 11 through 15, for more information about the AFA Board's oversight of the AIDA in its capacity as the AIDA Board of Directors).

Through the AFA and its related entities, the Office is responsible for:

- **Providing access to financing for statutorily authorized projects—**The AIDA issues taxable and tax-exempt conduit bonds to provide borrowers with financing for various statutorily authorized projects, including charter schools, healthcare facilities, multifamily housing, and commercial enterprises (see Questions and Answers, pages 34 through 43, for additional information about the AIDA's conduit bond program activities). The conduit bonds issued by the AIDA are not debt obligations of the State, the Office, the AFA, or the AIDA but instead are the responsibility of private borrowers. Additionally, through a limited liability company (LLC) the AIDA owns and controls, the AIDA also issued another type of security to facilitate a series of transactions between an investment bank and an insurance company (see Questions and Answers, pages 36 through 37, for more information about the AIDA's LLC and these transactions). According to AIDA records, it issued $1.98 billion in conduit bonds to finance 25 projects in fiscal year 2022. As of June 30, 2021, the AIDA reported that it had approximately $7.6 billion in outstanding principal conduit bond debt.[16,17]

- **Operating a State-wide down payment assistance program—**The AIDA operates the HomePlus program, a State-wide program that provides forgivable down payment/closing cost assistance and non-forgivable down payment loans to home buyers. Specifically, the HomePlus program provides:

  - **Forgivable down payment/closing cost assistance—**The HomePlus program provides borrowers with 30-year fixed-rate mortgages and additional financial assistance of up to 5 percent of the mortgage principal that the borrowers may use toward a down payment or closing costs. Borrowers must meet certain qualifications to participate in the program, including meeting the credit score and income limit requirements for federal mortgage programs, such as Federal Housing Administration mortgages. The AIDA forgives the financial assistance in equal installments over 36 months and borrowers must repay the balance of any unforgiven financial assistance if they sell or refinance their homes before the assistance is fully forgiven.[18] In calendar year 2021, the HomePlus program provided $50.9 million in down payment/closing cost assistance to Arizona homebuyers.

  - **Nonforgivable down payment loans—**In response to changing conditions in the mortgage market, in June 2022 the AIDA Board of Directors expanded the HomePlus program by authorizing the AIDA

[15] All industrial development authorities in the State, including the AIDA, have a governing body with specific statutory responsibilities, including approving the industrial development authority's formation, reviewing and approving proposed amendments to its articles of incorporation, and approving the proceedings under which it issues conduit bonds. See A.R.S. §§35-702, 35-704, and 35-721(B).

[16] The $7.6 billion includes approximately $1.9 billion of outstanding debt originally issued by the Arizona Health Facilities Authority.

[17] As of August 2022, the AIDA's most recently reported outstanding conduit bond debt was as of June 30, 2021.

[18] The AIDA sells the mortgages originated through the HomePlus program in the form of mortgage-backed securities to generate the revenues the AIDA uses to provide forgivable financial assistance. See Appendix B, pages b-1 through b-3, for more information.

to encumber $15 million of AIDA monies that otherwise would have been transferred to the Arizona Department of Housing's Housing Trust Fund to pay for up to 1,000 nonforgivable down payment assistance loans to Arizona homebuyers (see pages 9 through 10 for information about the AIDA's transfers to the Housing Trust Fund).[19] A borrower must meet the same mortgage qualification requirements and obtain a mortgage through the HomePlus program to receive a nonforgivable down payment loan equal to 5 percent of the mortgage principal. Borrowers are not required to pay principal or interest on the down payment loan while they own their home and use it as their primary residence. According to program guidelines, the full amount of a down payment loan must be paid to the AIDA if a borrower sells or refinances their property, rents the property, or fails to occupy the property as a primary residence. The AIDA Executive Director reported that the nonforgivable down payment loan program began operating in July 2022 and in its first month of operation, lenders reserved approximately $2.2 million in nonforgivable down payment loan monies for approved borrowers.[20]

- **Allocating the State's private activity bond volume cap—**Internal Revenue Code (IRC) §146 restricts the amount of certain tax-exempt private activity bonds that all bond issuers within a state may issue during each calendar year by setting a volume cap limit based on each state's population. States may carry forward unused volume cap allocation for up to 3 calendar years.[21] Statute requires the AFA to serve as the State's exclusive registry for tracking and allocating private activity bond volume cap each calendar year in accordance with a statutory formula.[22]

- **Paying outstanding debt—**The Greater Arizona Development Authority was created in 1997 to provide financial and technical assistance to local and tribal governments and special districts with the development of public infrastructure. It has not financed new infrastructure projects since 2010 and its only activity since fiscal year 2014 has been related to paying its outstanding debt, which it pays with monies it receives from local governments and special districts.[23] As of June 30, 2022, the Greater Arizona Development Authority's outstanding debt totaled approximately $7.1 million.

- **Transferring monies to the State—**The AFA and the AIDA are statutorily required to annually transfer all unencumbered monies in excess of their operating expenses to the State.[24] Specifically, at the end of each fiscal year, the AFA is required to transfer all unencumbered monies in its Operations Fund in excess of its operating expenses to the Office's Economic Development Fund (see Sunset Factors, pages 24 through 26, for more information about the AFA not making statutorily required transfers to the Economic Development Fund in fiscal years 2021 and 2022). Additionally, at the end of each fiscal year, the AIDA is required to transfer unencumbered monies in excess of its operating costs generated by its HomePlus program to the Housing Trust Fund administered by the Arizona Department of Housing.[25] After this transfer, statute requires the AIDA to transfer all remaining unencumbered monies, such as those generated by its conduit bond program and monies earned from interest to the Office's Economic Development Fund (see Appendix B, pages b-1 through b-3, for more information about the AIDA's transfers to the State).

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[19] According to the AIDA Board of Directors meeting packet from the meeting where the proposal to expand the HomePlus program was presented, changes in the mortgage market resulted in the AIDA being unable to sell mortgages it originated at a premium, which is how the AIDA generates revenue for the forgivable down payment assistance it provides to borrowers. According to the meeting packet, providing nonforgivable loans with AIDA monies would allow the HomePlus program to continue providing assistance to Arizona homebuyers while the forgivable assistance option is unavailable to them.

[20] According to AIDA officials, when borrowers work with a lender to qualify for a mortgage through the HomePlus program, lenders reserve AIDA down payment loan monies for each borrower but the AIDA does not provide these monies to a borrower until they complete the purchase of their home, and their mortgage files are reviewed and approved by the AIDA and its servicing bank for compliance with program requirements.

[21] 26 U.S.C. §146.

[22] A.R.S. §35-902.

[23] The Greater Arizona Development Authority receives monies from the local governments and special districts to which it provided financial assistance to pay its outstanding debt. See Appendix A, page a-14, for more information about the Greater Arizona Development Authority's financial activities.

[24] A.R.S. §§41-5352(D) and 35-751(C).

[25] A.R.S. §35-751(C).

Organization and staffing

As of June 2022, the Office reported that it had 31 filled full time-equivalent positions (FTE) and 4 vacancies assigned to its various programs. The Office also has a Governor-appointed Director who concurrently serves as the President/CEO for and is employed by the Commerce Authority.[26] Additionally, pursuant to an interagency service agreement, 6 Commerce Authority staff, totaling approximately 1.9 FTE, provide management and administrative services for the Office.[27] In addition to its Director, the Office comprises the following teams and offices overseen by Commerce Authority executives:

- **Labor market information team (17 FTEs and 0 vacancies)—**This team collects employment and workforce data and produces monthly employment and unemployment statistics for the State. Through interagency service agreements with the Department of Economic Security, this team also collects information required by the Bureau for federal reporting, such as the quarterly census of employment and wages. The Office's Labor Market Information Director leads this team with oversight from the Commerce Authority's Senior Vice President for Research.

- **Workforce team (8 FTEs and 4 vacancies)—**This team provides staffing support to the Workforce Arizona Council by coordinating with local workforce areas to complete their workforce plans, developing the State-wide workforce plan required by the federal WIOA, and administering State-wide workforce initiatives. The Office's Workforce Administrator leads this team with oversight from the Commerce Authority's Chief Operating Officer/Chief Financial Officer.

- **Data administration team (1 FTE and 0 vacancies)—**This team supports the Workforce Data Task Force and is responsible for managing the development and implementation of the State-wide workforce evaluation data system. This team comprises the Office's Database Administrator with oversight from the Commerce Authority's Senior Vice President of Operational Excellence.

- **Demographer's Office (3 FTEs and 0 vacancies)—**The Demographer's Office produces population estimates and projections for the State, counties, and municipalities. The Demographer's Office also coordinates with and supports the U.S. Department of Commerce's Census Bureau in its administration of the decennial census. The Office's State Demographer leads this team with oversight from the Commerce Authority's Senior Vice President for Research.

- **Accounting and procurement team (2 FTEs and 0 vacancies)—**This team is responsible for the Office's general operations and accounting functions. The Office's Finance Manager leads this team with oversight from the Commerce Authority's Chief Operating Officer/Chief Financial Officer.

Additionally, statute establishes the Office-supported Workforce Data Task Force, which comprises 5 members, and authorizes the Office Director to appoint additional advisory members.[28] As of June 2022, the Workforce Data Task Force had no vacancies, and the Office reported that its director had not appointed any advisory members.

The AFA Board comprises 5 Governor-appointed members who serve 3-year terms.[29] Statute requires the Governor to consider diverse geographical representation when making appointments to the AFA Board and prohibits AFA Board members from having a direct or indirect personal financial interest in any project financed

[26] The Office Director is not included in the Office's FTE total and does not receive a salary from the Office.

[27] Pursuant to the interagency service agreement between the Office and the Commerce Authority, the Office paid for between 20 and 50 percent of the salary and related expenses for the 6 Commerce Authority staff who provide management and administrative services to the Office. These 6 Commerce Authority staff are not included in the Office's FTE total.

[28] According to A.R.S. §41-5404, the Workforce Data Task Force members comprise the Office Director or the director's designee; the Director of the Department of Economic Security or the director's designee; the Superintendent of Public Instruction or the superintendent's designee; the President of the Arizona Board of Regents or the president's designee; and a representative of a community college district. Statute does not specify or limit the length of the term for Workforce Data Task Force members.

[29] A.R.S. §41-5353.

by the AFA or its related entities, the AIDA and the Greater Arizona Development Authority.[30] As of August 2022, the AFA Board had no vacancies, and its members included representatives from public and private industries with backgrounds in corporate finance, commercial real estate, construction, and business. Additionally, as of August 2022, the AFA has a Governor-appointed Executive Director who concurrently serves as the AIDA Executive Director.[31] The AFA reported that it had no other employees and relies on staff from related entities to perform its functions, such as the Water Infrastructure Finance Authority Executive Director, who is responsible for managing the AFA's private activity bond volume cap allocation process.

Revenues and Expenditures

As shown in Table 1 (see pages 9 through 10), the Office has various revenue sources including the State General Fund, portions of fees collected by the Arizona Corporation Commission, required transfers from the AFA and the AIDA, and various intergovernmental revenues and federal grants. For fiscal year 2022, the Office's revenues totaled approximately $8.9 million, and its expenditures and transfers totaled approximately $8.3 million. Most of the Office's expenditures were to pay for services from the Commerce Authority and payroll and related benefits.

[30] A.R.S. §§41-5353(A) and 41-5353(H).

[31] A.R.S. §41-5352(B). The AFA Executive Director does not receive a salary from the AFA and was appointed as the AIDA Executive Director by the AIDA Board of Directors through a resolution adopted in May 2021.

Table 1
Schedule of Office revenues, expenditures, and changes in fund balance[1]
Fiscal years 2020 through 2022
(Unaudited)

	2020	2021	2022
Revenues			
Statutorily required remittances[2]			
AIDA	$7,499,097	$6,732,430	$2,800,901
AFA Operations	257,000		
Intergovernmental[3]	2,488,086	2,866,581	3,594,243
Filing and registration fees[4]	2,072,632	2,118,507	2,058,047
State General Fund appropriations	510,489	478,989	467,208
Other		2,774	
Total gross revenues	12,827,304	12,199,281	8,920,399
Remittances to the State General Fund[5]	(15,352)	(4,856)	
Total net revenues	**12,811,952**	**12,194,425**	**8,920,399**
Expenditures and transfers			
Office directly paid expenditures			
Payroll and related benefits	2,423,602	2,652,617	2,496,534
Professional and outside services	219,755	481,722	355,431
Travel	37,694	484	898
Other operating			
Information technology-related[6]	286,408	249,438	1,026,800
Accounting, budgeting, and financial services	39,999	10,000	2,500
Telecommunication	29,136	26,893	14,696
Other	56,223	33,159	37,751
Total other operating	411,766	319,490	1,081,747
Furniture, equipment, and software[7]	480,021	1,129	80,277
Transfers to other State agencies			59,682
Total Office directly paid expenditures and transfers	3,572,838	3,455,442	4,074,569
Commerce Authority charges and reimbursements[8]			
Professional and outside services	708,974	3,300,733	4,039,152
Central Arizona College Workforce Training Center		1,586,253	
Other operating			
Rent	480,660	249,793	192,083
Information technology-related	13,964	5,400	5,280
Software	2,408	976	
Total Commerce Authority charges and reimbursements	1,206,006	5,143,155	4,236,515
Total expenditures and transfers	**4,778,844**	**8,598,597**	**8,311,084**
Net change in fund balance	8,033,108	3,595,828	609,315
Fund balance, beginning of year	3,476,085	11,509,193	15,105,021
Fund balance, end of year	**$11,509,193**	**$15,105,021**	**$15,714,336**

1 The table presents the Office's financial activity and does not include the financial activity related to the AFA and its related entities, the Greater Arizona Development Authority and the AIDA (see Tables 8 and 9, pages a-11 through a-13, for the AFA financial activity, Table 10, page a-14, for the Greater Arizona Development Authority financial activity, and Table 11, pages b-2 through b-3, for the AIDA financial activity). It also does not include the Water Infrastructure Finance Authority, which was transferred from the Office effective September 24, 2022.

2 Statutorily required remittances were monies the Office received from the AIDA and the AFA in excess of their operating costs in accordance with A.R.S. §§35-751(C) and 41-5352(D), respectively; however, the AIDA's transfers to the Office in fiscal year 2020 included approximately

Table 1 continued

$3.2 million for the AIDA's fiscal year 2019 activity transferred after fiscal year end in July 2019. In addition, the AFA did not transfer unencumbered monies for fiscal years 2021 or 2022. Consequently, the AFA owed approximately $1 million to the Office's Economic Development Fund on June 30, 2022, from fiscal years 2021 and 2022. The AFA transferred these monies to the Economic Development Fund in August 2022 (see Sunset Factors, pages 25 through 26, for additional information).

3 Intergovernmental revenues include approximately $2.5, $2.9, and $3.6 million of federal grants revenue in fiscal years 2020, 2021, and 2022, respectively. For example, the Office received approximately $835,300, $830,300, and $920,700 in fiscal years 2020, 2021, and 2022, respectively, from the Labor Force Statistics grant, a grant from the U.S. Department of Labor, to collect, analyze, and publish labor-related statistical data such as employment and unemployment, labor demand and turnover, wages, and earnings. See Table 4 on page a-4 for additional information on the Office's Federal Grant Fund, where most federal monies are accounted for.

4 Filing and registration fees were collected by the Arizona Corporation Commission and remitted to the Office in accordance with various statutes. For example, A.R.S. §44-1861(C) requires payment of a nonrefundable registration fee on the aggregate offering price of securities sold in the State and up to $500 of each fee is allocated to the Office.

5 Remittances to the State General Fund consisted of reimbursements from the U.S. Department of Commerce's Census Bureau to pay a portion of the Demographer's Office's payroll and related benefits, initially paid by the Office's General Fund, that were remitted to the State General Fund.

6 Information technology related expenditures in fiscal years 2020 through 2022 consisted of various expenditures such as software and maintenance costs and payments to the Department of Economic Security that, according to the Office, were for the Department of Economic Security's support of the State's workforce evaluation data system project (see page 3 for additional information). In addition, fiscal year 2022 included $683,000 that was paid for cloud hosting-related expenditures.

7 Fiscal year 2020 furniture, equipment, and software expenditures were primarily for licensing software related to the Arizona Career Readiness Credential program for a tool that, according to the software vendor, prepares job seekers for success.

8 Commerce Authority charges and reimbursements were for services provided by the Commerce Authority and reimbursements for expenditures the Commerce Authority incurred on behalf of the Office. For example:

- Professional and outside services included payments to the Commerce Authority pursuant to an interagency service agreement for administrative, technical support, and research services for all fiscal years. In addition, fiscal year 2021 included $2.1 million paid to the Commerce Authority in accordance with an interagency service agreement to provide up to $5.5 million from the Economic Development Fund for various services such as providing account-based marketing, supply chain development, and elevation of next-generation technologies in support of growing and expanding Arizona's economy. It also included $200,000 for a contribution to the Return Stronger Upskilling Partnership (see Table 4 on page a-4 for additional information).
- Central Arizona College workforce training center expenditures in fiscal year 2021 were reimbursements to the Commerce Authority for a workforce training center located at Central Arizona College. The Commerce Authority and the Office entered an interagency service agreement whereby the Office agreed to pay for up to $1.65 million toward the center's project costs, including design and construction of the new training facility.
- Rent expenditures were primarily the amounts charged for housing the Office in the Commerce Authority's building. According to a Commerce Authority executive, in fiscal year 2020, the Office paid higher rent charges because it moved into the Commerce Authority's offices, and it paid for the costs of modifying the Commerce Authority's space to accommodate the Office.

Source: Auditor General staff analysis of the Arizona Financial Information System *Accounting Event Transaction File* and the State of Arizona *Annual Financial Report* for fiscal years 2020 through 2022; and the State of Arizona *Annual Financial Report* for fiscal years 2020 and 2021.

AFA Board had not implemented needed controls to properly manage and oversee some AIDA activities, resulting in increased risk for errors and fraud

AFA Board's statutory designation as AIDA's board and best practices suggest that AFA Board should oversee AIDA's activities to help ensure AIDA achieves its objectives and reduces the risk of errors and fraud

As discussed in the Introduction (see page 1), statute requires the AFA Board to establish the AIDA and serve as the AIDA's board.[32] The AIDA's corporate bylaws also established the AIDA Board of Directors consisting of the members of the AFA Board. Best practices developed by the National Council on Nonprofits indicate that a nonprofit organization's board of directors is responsible for adopting management policies, including policies for legal governance and financial management, to ensure the organization meets its mission.[33] Additionally, according to best practices developed by the U.S. Government Accountability Office (GAO), a government entity's oversight body, such as its board of directors, and management should develop and implement internal controls to provide reasonable assurance that the entity's objectives will be achieved as well as information about how effectively the entity is operating.[34] According to GAO, an oversight body is also responsible for ensuring the entity's organizational structure is designed and implemented to enable it to effectively exercise its oversight responsibilities.

AFA Board's lack of oversight of AIDA's activities has resulted in AIDA being unaware of fees that were owed to it and being at increased risk for conflicts of interest, errors, and fraud

Based on our review of the AIDA's programs and activities during fiscal years 2020 through 2022, the AFA Board, acting in its capacity as the AIDA Board of Directors, has not ensured the AIDA's organizational structure is designed and implemented to enable it to effectively exercise its oversight responsibilities for the AIDA, including not separating responsibilities for key activities. Although our review did not identify any instances of fraud, this lack of controls increases the risk for fraud and resulted in various other problems and risks. Specifically:

- **AIDA's process for contract review and approval resulted in a contract with an apparent conflict of interest—**According to the terms of the current contract between the AIDA and its conduit bond program contractor, the AIDA's executive director is responsible for approving payments to the AIDA's

[32] A.R.S. §§41-5356(A)(1) and 35-705.

[33] National Council of Nonprofits. (n.d.) *Board roles and responsibilities*. Washington, DC. Retrieved 7/26/2022 from https://www.councilofnonprofits.org/tools-resources/board-roles-and-responsibilities.

[34] U.S. Government Accountability Office. (2014). *Standards for internal control in the federal government*. Washington, DC. Retrieved 4/6/2022 from https://www.gao.gov/assets/gao-14-704g.pdf.

contractor for its services, and the contractor is required to pay part of the AIDA executive director's annual compensation. Specifically, the contract requires the AIDA's contractor to pay the first of 4 quarterly bonus payments each year to the AIDA executive director. Additionally, the AIDA executive director's compensation agreement authorizes the contractor to pay the AIDA executive director an additional discretionary bonus payment.[35] As a result, the AIDA executive director has competing interests because he has a financial interest related to the quarterly and discretionary bonus paid by the contractor, and the AIDA executive director is also required to participate in matters related to that financial interest by approving payments to the same contractor. This is inconsistent with the State's conflict-of-interest laws, which require public officers and employees to avoid conflicts of interest that might influence or affect their official conduct.[36] The AIDA Board President reported that although he approved an amendment to the AIDA executive director's compensation agreement authorizing the discretionary bonus payment from the AIDA's contractor, the amendment was not reviewed or approved by the AIDA Board of Directors, consistent with the Board President's authority outlined in the AIDA's bylaws in place at the time the amendment was approved. Entering into contracts that include provisions creating real or perceived conflicts of interest may harm the AFA's and the AIDA's reputations since, according to the AIDA's articles of incorporation, the AIDA performs essential government functions and its activities should serve public purposes, and the AFA, a governmental entity, is statutorily designated as the board for the AIDA, suggesting it is responsible for overseeing the AIDA's activities.

- **Various AIDA transactions lack adequate separation of responsibilities, resulting in increased risk that borrowers do not pay all required fees and risk of improper payments and fraud—**The AIDA's contractor is authorized to negotiate various fees paid to the AIDA by conduit bond borrowers and reported that in some cases it has waived some fees for borrowers (see Questions and Answers, pages 41 through 42, for more information about fees the AIDA charges to conduit bond borrowers). For example, borrowers have the option of paying a 1-time upfront administrative fee negotiated between the borrower and the AIDA's contractor rather than paying an annual administrative fee. Additionally, the AIDA's contractor reported that when a borrower chooses to pay the administrative fee upfront, it waives the borrower's closing fee. The contractor reported that it calculates and assesses these fees similarly for all borrowers who choose the upfront option. However, the AIDA Board of Directors has not developed guidance for the contractor to follow when negotiating these fees, such as minimum and maximum fee parameters or the conditions under which certain borrower fees may be waived. Additionally, neither the AIDA Board of Directors nor another staff person, such as the AIDA executive director, reviews the fees after they have been negotiated. As a result, the AIDA cannot ensure that conduit borrowers pay all fees required by the AIDA's fee schedule.

  The AIDA's contractor is also solely responsible for reviewing, approving, and executing payments to other AIDA vendors. The AIDA's contractor reported that when the AIDA receives an invoice for goods or services, the contractor reviews and approves the invoice for payment, executes the payment on behalf of the AIDA through an online payment service, and forwards the invoice to the AIDA's accounting vendor to record. However, the invoices and underlying documentation are not reviewed by another staff person, such as the AIDA executive director, contrary to best practices.[37] Similarly, the AIDA's executive director is solely responsible for reviewing and approving monthly payment requests received from the AIDA's contractor for its services, and upon the AIDA executive director's approval, the contractor is then responsible for executing payment to itself on behalf of the AIDA, inconsistent with best practices. By not separating these responsibilities for processing payments, the AIDA increases the risk of errors and improper payments. Additionally, although our review did not identify any instances of fraud, not separating these responsibilities increases the risk for various types of fraud, such as fictitious vendor schemes.

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[35] According to the terms of the AIDA Executive Director's compensation agreement, he may earn up to $200,000 in bonus payments annually, including the quarterly bonus payment and any discretionary bonus payments paid by the AIDA's contractor.

[36] A.R.S. §38-501 et seq. According to A.R.S. §38-501(A), the State's conflict-of-interest laws apply to all public officers and employees of the State, including public officers and employees of political subdivisions such as the AIDA.

[37] GAO indicates that separating responsibilities helps prevent fraud, waste, and abuse in an entity by considering the need to separate authority, custody, and accounting in the organizational structure. See GAO, 2014.

- **AIDA's process for reviewing and approving contractor payments lacked detailed review, resulting in payment errors and increased risk for improper payments and fraud—**Our review of 7 monthly payment requests the contractor submitted to the AIDA in fiscal years 2020 through 2022 found that they were approved by the AIDA Board President or the AIDA executive director despite lacking detailed documentation to support the payment amounts or containing errors.[38] Specifically, our review of 4 monthly payment requests submitted by the contractor for AIDA Board President approval between December 2019 and May 2021 found that none of the 4 requests included detailed documentation supporting the payment amounts.[39] Instead, the payment requests included a summary of the AIDA's monthly activity, and a payment amount based on that reported activity. The AIDA Board President approved all 4 of the payment requests we reviewed, including 1 that led to a $200 underpayment to the AIDA's contractor. Additionally, our review of 3 monthly payment requests submitted to the AIDA executive director for approval since May 2021 indicated that 2 of the 3 requests were approved by the AIDA executive director despite containing errors leading to overpayments to the AIDA's contractor.[40] For example, in October 2021, the AIDA overpaid its contractor by approximately $63 because the contractor's payment request reported $250 in revenue for a homebuyer education fee that the AIDA did not receive, despite the executive director who approved the payment request being responsible for overseeing the AIDA's HomePlus program activity.[41] By not requiring supporting documentation and a detailed review for its contractor's payment requests, the AIDA increases the risk for additional errors, improper payments, and fraud.

- **AIDA's lack of monitoring of its LLC resulted in AIDA being unaware of approximately $35,000 in fee monies that should have been paid to it—**As discussed in the Questions and Answers (see pages 36 through 37), in March 2020, the AIDA created an LLC to facilitate a series of transactions between an investment bank and an insurance company. Although the LLC is wholly owned by the AIDA and controlled by the AIDA's Board of Directors, the AIDA executive director and the AIDA Board of Directors did not monitor its activities and/or require the contractor to monitor its activities and was unaware that the LLC had accumulated fees that should have been paid to it. Specifically, in response to our requests for information about its LLC, the AIDA determined that the vendor it had engaged to provide valuation and accounting services for the series of transactions, such as preparing monthly and annual transaction reports, did not provide these services and accordingly, did not request payment. As a result, the trustee for the LLC's activities had accumulated approximately $35,000 in fees paid by borrowers that should have been paid to the AIDA, but that the AIDA was not expecting to receive. During the audit, the AIDA directed its trustee to pay these accumulated fees to the AIDA. Although the AIDA reported that the LLC was intended to operate without the AIDA's ongoing involvement, the LLC is wholly owned by the AIDA and controlled by the AIDA Board of Directors. Without processes to monitor the LLC, the AIDA increases the risk that it may not be aware of unexpected activity, such as the accumulated fees that should have been paid to the AIDA identified during our review.

- **AIDA's lack of documented project approval criteria and review process increases risk of approving projects that do not meet the AIDA Board of Directors' stated expectations—**The AIDA's articles of incorporation state that its activities should serve public purposes and should further the health, safety, and welfare of Arizona residents. Additionally, the AIDA Board of Directors members we interviewed

[38] The monthly payment requests we reviewed ranged in amount from approximately $363,000 to approximately $1.2 million.

[39] Before May 2021, the contractor sent the payment requests to the AIDA Board President for review and approval because the AIDA did not have an executive director. In May 2021, the AIDA Board of Directors appointed an executive director, and since then, the AIDA executive director has been responsible for reviewing and approving payment to the AIDA's contractor.

[40] The payment requests the AIDA's contractor submitted for approval since June 2021 that we reviewed also did not include detailed documentation supporting the payment request. However, since May 2021, the contractor's fee is based on the HomePlus program activity, which is overseen by the AIDA executive director, and therefore the executive director had access to the detailed documentation necessary to support the requested payment amount.

[41] According to the terms of the contract between the AIDA and its contractor, the contractor is entitled to 25 percent of revenues generated by the HomePlus program (see Sunset Factor 12, pages 32 through 33, for more information about the terms of the contract between the AIDA and its contractor). The overpayment of approximately $63 represents 25 percent of the $250 in revenue the AIDA did not receive.

reported that conduit bonds should provide a benefit to the State and that they consider the benefit to the State when deciding whether to vote to approve projects for financing. The AIDA's contractor reported that the AIDA Board of Directors has other expectations that conduit bond projects should meet to be approved, such as having the support of the jurisdiction where the project is located. However, our review of 9 informational packets prepared by the AIDA's contractor and provided to the AIDA Board of Directors members in advance of meetings held between April 2019 and June 2022 found that the packets did not include specific information relevant to these criteria, such as explaining how some projects will benefit the State or outlining that the projects were supported by the jurisdictions where the projects were located. Additionally, the AIDA's procedural pamphlet for borrowers and application for conduit bond financing do not inform potential borrowers about these criteria or require potential borrowers to explain in their applications how their proposed projects meet these criteria. Absent such information in the packets the AIDA Board of Directors uses to review projects for approval, the AIDA risks approving projects that do not meet its stated expectations and may lack evidence to demonstrate that its activities serve public purposes, as stated by its articles of incorporation.

AFA Board, acting in its capacity as AIDA Board of Directors, delegated oversight to AIDA Board of Directors President and did not address challenges resulting from AIDA's small number of staff

GAO assigns specific responsibilities to an entity's oversight body related to internal controls, including overseeing management's design, implementation, and evaluation of internal control activities and ensuring identified deficiencies are remedied.[42] However, the AFA Board, acting in its capacity as the AIDA Board of Directors, did not ensure that needed controls were developed and implemented for the AIDA, contributing to the previously identified deficiencies. Instead, contrary to GAO's best practices, the AFA Board, acting in its capacity as the AIDA Board of Directors, delegated responsibility for AIDA oversight to a single individual without establishing any mechanisms to monitor or oversee the delegated responsibility. Specifically, the AIDA's corporate bylaws authorized the AIDA Board President to handle all business on behalf of the AIDA without the AIDA Board of Directors' approval, with the exception of approving conduit bond issuances. Additionally, the AIDA Board of Directors did not oversee the responsibilities delegated to the AIDA Board President. For example, the AIDA Board of Directors members we interviewed reported that other than approving conduit bond issuances, they were not involved in AIDA activities, such as reviewing and approving compensation agreements with the AIDA's executive director and contracts with the AIDA's conduit bond program contractor. During the audit, the AIDA Board of Directors amended the AIDA's corporate bylaws to require the entire Board of Directors' approval for various corporate powers the bylaws had previously delegated to the AIDA Board President, such as entering into contracts.

Additionally, GAO best practices assign entity management responsibility for designing, implementing, and evaluating the effectiveness of internal controls, and indicate that if separating responsibilities is not practical within an operational process because of limited personnel or other factors, management should design alternative control activities to address the risk of fraud, waste, or abuse in the operational process. Although the AIDA has a single employee, the AIDA executive director, neither the AIDA Board of Directors nor the AIDA executive director have taken steps to design and implement alternative control activities to compensate for the lack of separation of responsibilities in the AIDA's processes. For example, the AIDA Board of Directors could assign some review responsibilities to its members. Additionally, the State of Arizona Accounting Manual (SAAM) recommends outsourcing certain accounting functions or staff sharing with other agencies as potential compensating controls when an appropriate level of separating responsibilities is difficult to achieve.[43]

[42] GAO, 2014.

[43] The SAAM contains the State's accounting policies and procedures and is published by the Arizona Department of Administration's General Accounting Office in accordance with statute.

Recommendations

The AFA Board should:

1. Ensure the AIDA Board of Directors works with the AIDA's executive director and contractor to develop and implement written policies and procedures documenting a comprehensive system of internal controls for the AIDA consistent with GAO's best practices. These policies and procedures should outline specific control activities, including but not limited to:

    a. Outlining criteria the AIDA's contractor should use for negotiating conduit bond program fees with borrowers, including minimum and maximum fee parameters and the conditions under which fees may be waived, and developing a process to review and approve the fees negotiated by its contractor to ensure they are consistent with the criteria.

    b. Implementing processes to ensure the AIDA receives all fees owed to it, including monitoring the activities of its LLC.

    c. Separating responsibilities and/or implementing compensating controls for paying vendors, including ensuring that the AIDA's contractor is not responsible for executing payments to itself.

    d. Reviewing invoices and supporting documentation before authorizing payment to vendors.

2. Reassign responsibilities or implement compensating controls to eliminate the AIDA executive director's competing interests related to approving payments to the AIDA's contractor.

3. Ensure the AIDA Board of Directors documents its criteria for approving conduit bond projects for financing and requiring applicants to provide information about how their projects meet these criteria.

AFA Board response: As outlined in its **response**, the AFA Board agrees with the finding and will implement the recommendations.

Office lacked documentation of services received in exchange for payments made to Commerce Authority and may have allocated some of these costs to federal programs inconsistent with federal requirements

Office lacked documentation of the services received in exchange for over $260,000 in payments it made annually to Commerce Authority in fiscal years 2020 through 2022, inconsistent with SAAM

The SAAM requires that expenditures of public monies be for valid public purposes and that the cost of goods or services purchased with public monies should not exceed the benefit to the State. Further, the SAAM requires that these expenditures be reasonable, justified, prudent, and documented. However, the Office has paid the Commerce Authority for services without ensuring the costs it paid for the services was commensurate with the benefits it received from the Commerce Authority. Specifically, the Office has entered and periodically updated service agreements with the Commerce Authority in fiscal years 2020 through 2022 in which it agreed to pay between $261,800 and $269,600 annually to the Commerce Authority in exchange for various administrative and technical services, such as human resources and public relations functions and services provided by various Commerce Authority executive staff. However, the Office lacked documentation of the services and benefits it received in exchange for these payments. Specifically:

- Commerce Authority records indicate that the Office's fiscal years 2020 through 2022 annual payments, which ranged between $261,800 and $269,600 annually for administrative and technical services, paid for between 20 and 50 percent of the salary and related expenses for 6 Commerce Authority staff. However, the Office did not provide documentation to support that these Commerce Authority staff spent proportionate time working on Office activities. Additionally, documentation we reviewed indicates that these Commerce Authority staff do not track the time they spend in support of Office activities.

- The Office's fiscal year 2022 agreement with the Commerce Authority for administrative and technical services did not include information to demonstrate the benefits the Office expected to receive in exchange for the monies it paid to the Commerce Authority, such as specific deliverables, performance measures, or other metrics related to the agreed-upon services that should be provided.

- The invoices and supporting documentation we reviewed related to payments for administrative and technical services did not provide any further details about the services and benefits that were provided to the Office in exchange for between $261,800 and $269,600 it paid annually to the Commerce Authority for fiscal years 2020 through 2022 and specified only the billing period and amount due.

Office lacks evidence of the benefits it received from its use of public monies and may have inappropriately allocated costs to federal programs

Without requiring the Commerce Authority to provide documentation to support the services and benefits the Office received in exchange for its payments to the Commerce Authority, the Office lacks evidence to demonstrate that the monies it paid to the Commerce Authority did not exceed the benefits it received, as required by the SAAM. Specifically, in fiscal years 2020 through 2022, the Office paid approximately $795,000 to the Commerce Authority for administrative and technical services, but it lacks documentation to support that the costs it paid for the services did not exceed the benefits it received. Additionally, without requiring detailed documentation regarding specific deliverables, performance measures, or other metrics related to the services the Commerce Authority is expected to provide in exchange for monies the Commerce Authority received, the Office limited its ability to hold the Commerce Authority accountable for providing these services according to the terms of its agreements.

The Office also receives federal program monies for some of its responsibilities, such as its Labor Market Information and Workforce responsibilities, and federal regulations require that costs allocated to federal programs be in accordance with the services and benefits received by the program.[44] However, because the Office lacked documentation supporting the amounts it paid to the Commerce Authority for administrative and technical services, it similarly lacked documentation to support that the federal programs to which it allocated some of these costs received benefits in accordance with the costs charged to them. Further, due to the lack of documentation, we could not determine if the Office's allocation of costs for administrative and technical services to 3 federal programs in fiscal years 2020 through 2022 was consistent with federal requirements. By allocating these costs to its various federal programs without ensuring each federal program's allocation was in accordance with the benefits it received, the Office risks that at least some of the administrative and technical costs it allocated to these programs, which total at least $330,000 for the period July 2019 through March 2022, may be unallowable costs for which the federal government may seek repayment.[45]

Office and Commerce Authority have integrated their operations despite being separate legal entities, and Office management has not taken some steps to ensure independence from Commerce Authority

Although the Office and the Commerce Authority are separate legal entities with separate enabling statutes, the Office's and the Commerce Authority's operations are integrated. For example, as discussed in the Introduction (see pages 7 through 8), the Office's Director also serves as President and CEO of Commerce Authority, and various Commerce Authority staff are responsible for overseeing Office activities. Further, the Commerce Authority's website and other documentation, such as its annual reports, refer to the Office as a component unit of the Commerce Authority. For example, the Commerce Authority's 2021 annual report makes several references to the Office as "Commerce Authority's Office of Economic Opportunity" without clarifying that the Office is a separate State agency and legal entity. Similarly, the Commerce Authority's fiscal year 2022 strategic plan description notes that the "Commerce Authority also houses the Office of Economic Opportunity," although no such statutory relationship exists between the 2 entities.

Office officials reported that the Office and the Commerce Authority integrated their operations to achieve various efficiencies, such as cost savings resulting from not having to employ full-time management staff for the Office. Office officials further reported that the Office was intended to operate as part of the Commerce Authority when it was created, which is consistent with some documentation we reviewed from the time of

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[44] 2 Code of Federal Regulations (CFR) §200.405(a).

[45] As part of our responsibilities to report on the State's compliance with federal Single Audit requirements, we will report a finding on these costs within the State's fiscal year 2021 Single Audit report.

the Office's creation. For example, in a February 2016 legislative committee hearing related to the legislation that created the Office, in response to a question from a legislative member about the Office's structure, the Director of the Governor's Office of Strategic Planning and Budgeting at that time testified that the Office's Director would report directly to the Commerce Authority President/CEO.[46] However, the legislation that created the Office established it as a separate legal entity from the Commerce Authority and did not include any requirements or provisions to indicate that the Office should be operated as part of the Commerce Authority. Additionally, because the Office's and Commerce Authority's operations are integrated, the Office may face difficulties ensuring the Office's independence from the Commerce Authority, such as engaging in arms-length transactions with the Commerce Authority.[47] For example, the various service agreements we reviewed were signed on behalf of the Office by its Director and on behalf of the Commerce Authority by the Commerce Authority's Chief Financial Officer/Chief Operating Officer, who reports directly to the Office Director in her capacity as President and CEO of the Commerce Authority. However, the Office lacked policies, procedures, or other written guidance outlining how it ensured that each of these 2 individuals independently assessed the benefits of the agreement to the entity for which they were the signatory. Additionally, as previously discussed, the agreements did not include information to demonstrate the specific benefits the Office expected to receive in exchange for its payments to the Commerce Authority. By not establishing processes for maintaining the Office's independence and separation from the Commerce Authority consistent with statute, the Office does not have the ability to ensure its agreements with the Commerce Authority, such as the service agreements we reviewed, benefit the Office and help it to meet its statutory responsibilities.

Recommendations

The Office should:

4. Develop and implement processes to document and monitor the benefits and services that the Commerce Authority provides to the Office, including a process to track and document the time Commerce Authority staff spend on Office activities.

5. Annually evaluate and update its service agreements with the Commerce Authority to ensure that the costs it pays for Commerce Authority services is commensurate with the benefits and services it receives.

6. Ensure it complies with federal requirements for allocating costs to federal programs, including documenting that the costs it allocates to federal programs are in accordance with the benefits received by those programs.

7. Work with the Commerce Authority to develop and implement processes for establishing independence and separation between the 2 entities, consistent with their statutorily established structure as separate legal entities.

Office response: As outlined in its **response**, the Office agrees with the finding and will implement the recommendations.

46 Hearing before the Arizona House of Representatives Committee on Commerce, 52nd Leg., Second Regular Session. (February 2016). Retrieved from https://www.azleg.gov/videoplayer/?eventID=2016021317&startStreamAt=737. At the time of this hearing, the legislation referred to the Office as the Governor's Economic Opportunity Office, which was later changed to the Office of Economic Opportunity.

47 The American Institute of Certified Public Accountants defines an arms-length transaction as a transaction conducted on such terms and conditions between a willing buyer and a willing seller who are unrelated and acting independently of each other and pursuing their own best interests.

Office did not comply with a key State conflict-of-interest requirement, increasing risk that employees and public officers had not disclosed substantial interests that might influence or could affect their official conduct

Statute addresses conflicts of interest for public agency employees and public officers

Arizona law requires employees of public agencies and public officers to avoid conflicts of interest that might influence or affect their official conduct. To determine whether a conflict of interest exists, employees/public officers must first evaluate whether they or a relative has a "substantial interest" in (1) any contract, sale, purchase, or service to the public agency or (2) any decision of the public agency.

Key terms

- **Substantial interest—**Any direct or indirect monetary or ownership interest that is not hypothetical and is not defined in statute as a "remote interest."
- **Remote interest—**Any of several specific categories of interest defined in statute that are exempt from the conflict-of-interest requirements. For example, an employee or public officer who is reimbursed for actual and necessary expenses incurred while performing official duties.

Source: Auditor General staff review of A.R.S. §38-502 and the *Arizona Agency Handbook*. Arizona Office of the Attorney General. (2018). *Arizona agency handbook*. Phoenix, AZ. Retrieved 5/24/2022 from https://www.azag.gov/outreach/publications/agency-handbook.

If an employee/public officer or a relative has a substantial interest, statute requires the employee/public officer to fully disclose the interest and refrain from voting upon or otherwise participating in the matter in any way as an employee/public officer.[48,49] The interest must be disclosed in the public agency's official records, either through a signed document or the agency's official minutes. To help ensure compliance with these statutory requirements, the Arizona Department of Administration's (ADOA) State Personnel System employee handbook and conflict-of-interest disclosure form (disclosure form) require State employees to disclose if they have any business or decision-making interests, secondary employment, and relatives employed by the State at the time of initial hire and anytime there is a change. The ADOA disclosure form also requires State employees to attest that they do not have any of these potential conflicts, if applicable, also known as an "affirmative no." In addition, A.R.S. §38-509 requires public agencies to maintain a special file of all documents necessary to memorialize all disclosures of substantial interest, including disclosure forms and official meeting minutes, and to make this file available for public inspection.

[48] See A.R.S. §§38-502(3) and 38-503(A) and (B).

[49] A.R.S. §38-502(8) defines "public officer" as all elected or appointed officers of a public agency established by charter, ordinance, resolution, State constitution, or statute. According to the *Arizona Agency Handbook*, public officers include directors of State agencies and members of State boards, commissions, and committees—whether paid or unpaid.

In response to conflict-of-interest noncompliance and violations investigated in the course of our work, such as employees/public officers failing to disclose substantial interests and participating in matters related to these interests, we have recommended several practices and actions to various school districts, State agencies, and other public entities.[50] Our recommendations are based on guidelines developed by public agencies to manage conflicts of interest in government and are designed to help ensure compliance with State conflict-of-interest requirements by reminding employees/public officers of the importance of complying with the State's conflict-of-interest laws.[51] Specifically, conflict-of-interest-recommended practices indicate that all public agency employees and public officers annually complete a disclosure form. These recommended practices also indicate that agencies develop a formal remediation process and provide periodic training to ensure that identified conflicts are appropriately addressed and help ensure conflict-of-interest requirements are met.

Office did not comply with a key State conflict-of-interest requirement, and its conflict-of-interest process was not fully aligned with recommended practices

The Office did not comply with a key State conflict-of-interest requirement, and its conflict-of-interest process was not fully aligned with recommended practices designed to help ensure that employees comply with State requirements. Specifically, the Office did not require its employees to submit a completed disclosure form to it upon hire. We requested disclosure forms for 6 judgmentally selected Office employees, but the Office could not provide completed disclosure forms for any of the 6 employees. The Office reported that it relied on ADOA to ensure its employees filed conflict-of-interest disclosure forms upon hire and believed its employees had completed disclosure forms during ADOA's onboarding process for new employees when they enter State service. However, the Office did not retain a copy of the completed disclosure forms, inconsistent with the form instructions, and reported that ADOA was unable to provide completed disclosure forms for the 6 employees.

Additionally, although not required by statute or ADOA, the Office did not annually remind its employees to complete a disclosure form when their circumstances change, consistent with recommended practices. It also had not developed comprehensive conflict-of-interest policies and procedures, including policies and procedures establishing responsibility and processes for reviewing disclosure forms and remediating disclosed conflicts, and requiring periodic conflict-of-interest training for its employees related to their unique programs, functions, or responsibilities.

Office's noncompliance with key State conflict-of-interest requirements increased risk that employees did not disclose substantial interests that might influence or affect their official conduct

The Office's noncompliance with a key State conflict-of-interest requirement and not fully aligning its conflict-of-interest process with recommended practices increased the risk that Office employees would not disclose substantial financial and decision-making interests that might influence or affect their official conduct. Specifically, by failing to ensure that its employees completed a conflict-of-interest disclosure form upon hire, not reminding employees at least annually to update their forms when circumstances change, and failing to review disclosure forms and remediate disclosed conflicts, the Office is not able to ensure that its employees

[50] See, for example, Arizona Auditor General reports 21-402 *Higley Unified School District—Criminal Indictment—Conspiracy, Procurement Fraud, Fraudulent Schemes, Misuse of Public Monies, False Return, and Conflict of Interest*, 19-105 *Arizona School Facilities Board—Building Renewal Grant Fund*, and 17-405 *Pine-Strawberry Water Improvement District—Theft and misuse of public monies*.

[51] Recommended practices we reviewed included: Organization for Economic Cooperation and Development. (2022). *Recommendation of the council on OECD guidelines for managing conflict of interest in the public service*. Paris, France. Retrieved 5/25/2022 from https://legalinstruments.oecd.org/public/doc/130/130.en.pdf; Ethics & Compliance Initiative. (2016). *Conflicts of interest: An ECI benchmarking group resource*. Arlington, VA. Retrieved 5/25/2022 from https://www.ethics.org/wp-content/uploads/2021-ECI-WP-Conflicts-of-Interest-Defining-Preventing-Identifying-Addressing.pdf; and Controller and Auditor General of New Zealand (2020). *Managing conflicts of interest: A guide for the public sector*. Wellington, New Zealand. Retrieved 5/25/2021 from https://oag.parliament.nz/2020/conflicts/docs/conflicts-of-interest.pdf.

disclosed substantial interests and refrained from participating in any manner related to these interests, as required by statute.[52] Additionally, the Office lacked a method to track which and how many employees disclosed a substantial interest, increasing the risk that it did not maintain all disclosures of substantial interest in a special file available for public inspection, as required by statute.[53]

Recommendations

The Office should:

8. Develop and implement conflict-of-interest policies to help ensure compliance with State conflict-of-interest requirements, including:

    a. Requiring employees/public officers to complete a conflict-of-interest form upon hire/appointment, including attesting that no conflicts exist, if applicable.

    b. Reminding employees/public officers at least annually to update their disclosure form when their circumstances change.

    c. Storing all substantial interest disclosures, including disclosure forms and meeting minutes, in a special file available for public inspection.

    d. Establishing a process to review and remediate disclosed conflicts.

9. Develop and provide periodic training on its conflict-of-interest requirements, process, and disclosure form, including providing training to all employees and public officers on how the State's conflict-of-interest requirements relate to their unique programs, functions, or responsibilities.

Office response: As outlined in its **response**, the Office agrees with the finding and will implement the recommendations.

[52] A.R.S. §38-503.

[53] A.R.S. §38-509.

Pursuant to A.R.S. §41-2954(D), the legislative committees of reference shall consider but not be limited to the following factors in determining the need for continuation or termination of the Office. The sunset factor analysis includes additional findings and recommendations not discussed earlier in the report.

Additionally, as discussed in the Introduction (see page 1), although the Water Infrastructure Finance Authority was established within the Office, during our review and effective September 24, 2022, Laws 2022, Ch. 366, removed the Water Infrastructure Finance Authority from the Office, created the Water Infrastructure Finance Authority Board, and transferred responsibility for overseeing the Water Infrastructure Finance Authority from the AFA Board to the Water Infrastructure Finance Authority Board. Prior to these changes, the Water Infrastructure Finance Authority had a separate termination date from the Office, and we conducted a performance audit and sunset review of the Water Infrastructure Finance Authority that was issued in September 2021.[54] As a result, the Water Infrastructure Finance Authority's statutory responsibilities and activities are not discussed within the sunset factors responses below.

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

The Office was established in 2016 to consolidate and improve the State's analytic capacity and track the State's key economic indicators. The Office's responsibilities include serving as the State's workforce planning coordinator and providing support to the Workforce Arizona Council, developing and maintaining a State workforce evaluation data system, producing constitutionally required population estimates for the State and its counties, and monitoring the State's tax and regulatory competitiveness.

The AFA was also established within the Office in 2016 to consolidate the responsibilities of various financing entities throughout the State, including the Arizona Health Facilities Authority, the Arizona Housing Finance Authority, and the Arizona International Development Authority.[55] Through the AFA and its related entity the AIDA, the Office is responsible for operating a conduit bond program to provide financing for statutorily authorized projects (see Questions and Answers, pages 34 through 43, for more information) and operating a State-wide down payment assistance program for Arizona homebuyers. Additionally, the AFA is the State's exclusive registry for tracking and allocating the State's private activity bond volume cap allocation (see Introduction, page 6, for more information about the State's private activity bond volume cap allocation).

We reviewed 5 western states—California, Colorado, Nevada, Texas, and Utah—and found that none met the Office's objectives and purposes through private enterprise. Additionally, we reviewed 5 states with financing agencies similar to the AFA and its affiliated entities—California, Florida, Massachusetts, Washington, and Wisconsin—and none of these 5 states met the AFA's objectives and purposes through private enterprise.

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

The Office, including the AFA and its related entities, uses various processes to help meet its statutory objectives and purposes. Examples of these processes for the statutory responsibilities we reviewed include:

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[54] See Arizona Auditor General report 21-115 *Water Infrastructure Finance Authority of Arizona*.

[55] Laws 2016, Ch. 372, §52.

- **Supporting State-wide workforce planning and providing labor market information—**Statute requires the Office to serve as the State's workforce planning coordinator, provide staffing support to the Workforce Arizona Council, and provide labor market information to inform the State's workforce strategy.[56] The Office has developed various processes related to these responsibilities, including:
    - Providing staffing support to the Workforce Arizona Council. Office staff assist the Workforce Arizona Council in implementing the State's workforce development system by working with local workforce development boards to implement local workforce plans; developing and updating the State's workforce plan;[57] and monitoring and reporting on State-wide workforce performance measures related to the State's workforce development efforts.
    - Collecting labor market data and conducting analysis used in the State workforce plan. The Office collects and analyzes data included in the State's workforce plan, such as the number of individuals employed and average annual wages for in-demand industries, the education requirements for occupations within in-demand industries, and future State employment trends.
- **Developing an IT security plan consistent with credible industry standards for the State workforce evaluation data system—**As discussed in the Introduction (see page 3), the data system is an IT system developed by the Office to compile information from various State agencies and educational institutions to allow analysis of how these agencies and educational institutions affect the lives of Arizonans over a period of time. As of June 2022, the Office was in the process of implementing the data system. The Office has developed an IT security plan for the data system that describes the controls in place or planned for implementation that includes controls consistent with the ADOA Arizona Strategic Enterprise Office's requirements and credible industry standards for IT security. For example, the Office has developed and implemented a data governance policy that establishes requirements for accessing and using the data system. The Office has also developed other standards and procedures, such as procedures to ensure only authorized users can access the system and to assess system security threats, and standards to ensure the system information's integrity. Additionally, the Office has started developing a contingency plan for the data system that is part of an overall organizational program for helping to ensure continuity of operations for mission/business functions in the event of an emergency or disaster.
- **Producing population estimates and projections—**As discussed in the Introduction (see pages 3 through 4), the Office includes the Demographer's Office, which is responsible for producing annual population estimates for the State, counties, incorporated municipalities, and unincorporated areas. The Demographer's Office has developed a methodology for calculating annual population estimates and has published these estimates on the Commerce Authority website. The Demographer's Office has also developed a methodology for producing population projections for the State and its counties, and the Phoenix and Tucson metropolitan areas that include details about expected annual population by age and sex, expected annual number of births and deaths, and expected annual migration trends. The Demographer's Office publishes updated population projections for the State and its counties in years that end in 2, 5, and 8, and publishes updated population projections for sub-county areas in the years following the publication of the updated State and county projections.[58] As of August 2022, the Commerce Authority's website included the Demographer's Office's State and county population projections for each year through 2055 that were published in 2018, and sub-county population estimates for each year through 2055 that were published in 2019.
- **Monitoring the State's tax and regulatory competitiveness—**The Office monitors the State's tax and regulatory competitiveness in various ways, as required by A.R.S. §41-5303, including:

[56] A.R.S. §41-5303(A)(2).

[57] WIOA requires each state to submit a plan outlining a 4-year strategy for the state's workforce development system to the Secretary of the U.S. Department of Labor.

[58] A sub-county area is defined as a municipality within a county or the aggregate of unincorporated areas in a county.

- Providing financial support to the Commerce Authority's Arizona Competitiveness Team to identify competitor states, collect information about various taxes in these states, such as corporate and individual income taxes, state and local sales taxes, and property taxes, and use this information to assess the State's tax competitiveness across key industries. The Office has also prepared informational briefs comparing Arizona's tax environment to the identified competitor states. According to the Office, the Commerce Authority uses the informational briefs for its efforts to attract business to the State.

- Tracking and reporting on various information related to the State's regulatory competitiveness. For example, on the Commerce Authority website, the Office provides information about the total number of administrative rules, words, and restrictive words in the Arizona Administrative Code; the number of administrative rules that State agencies revised or eliminated over a 1-year period; and the estimated annual savings for the State economy resulting from eliminated or revised administrative rules.[59]

- **Operating the HomePlus program to help Arizona homebuyers—**The AIDA operates a down payment assistance program, HomePlus, that provides financial assistance for down payments and closing costs to homebuyers throughout the State. In calendar year 2021, HomePlus originated 5,183 mortgages with an aggregate principal of $1.38 billion and provided $50.9 million in down payment/closing cost assistance to homebuyers. Statute requires unencumbered revenues generated by the HomePlus program be annually transferred to the Arizona Department of Housing's Housing Trust Fund.[60] Since its inception through June 30, 2022, the AIDA had transferred approximately $43.7 million to this fund. See Sunset Factor 3, pages 29 through 30, for more information.

However, we identified several deficiencies in the Office's and the AFA's and its related entities' processes. Specifically:

- **Office and AFA Board had not implemented internal controls for AFA's private activity bond volume cap allocation process, resulting in increased risk of loss or theft of public monies and noncompliance with statute—**The AFA is statutorily responsible for allocating the State's private activity bond volume cap to borrowers (see Introduction, page 6, for more information about the private activity bond volume cap).[61] The AFA has assigned the Water Infrastructure Finance Authority Executive Director as its volume cap program manager in addition to his duties related to the Water Infrastructure Finance Authority. As part of the process for allocating the State's private activity bond volume cap, the AFA receives various monies from borrowers, such as application and confirmation fees and security deposits. The SAAM includes specific requirements for State agencies related to receiving and accounting for cash and cash equivalents, including checks, such as having written policies and procedures for cash handling and separating cash-handling responsibilities. Additionally, as previously discussed (see Finding 1, pages 11 through 15), GAO best practices indicate that a government entity's oversight body and management should develop and implement internal controls, such as monitoring and reporting activities related to its operations, to help provide reasonable assurance that the entity's objectives will be achieved.

  Although the AFA had established processes for allocating private activity bond volume cap, including tracking the allocations and requiring documentation from borrowers prior to refunding security deposits, these processes were not documented in written policies and procedures and did not separate duties related to receiving payments from borrowers and authorizing the return of security deposits. Specifically, the AFA's volume cap program manager reported that he is responsible for most aspects of receiving and processing applications and fee payments from borrowers without secondary review or oversight of these activities. In addition, although the Water Infrastructure Finance Authority accounting staff are involved in

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[59] The total restrictive word count is the total count of each instance of the words or phrases "shall," "must," "required," "may not," and "prohibited" in the Arizona Administrative Code.

[60] A.R.S. §35-751(C)(1).

[61] The security deposits are refundable to borrowers if their private activity bonds are issued before their allocation expires but are forfeited to the AFA if their bonds have not been issued when their allocation expires.

depositing checks received by the AFA, the AFA's volume cap program manager is solely responsible for receiving and logging checks from borrowers, inconsistent with SAAM requirements.

Additionally, the AFA Board and management had not implemented internal controls as recommended by GAO for the AFA's processes for handling and accounting for private activity bond volume cap monies it received. Specifically, the AFA's private activity bond volume cap allocation process policies do not include any requirements for monitoring the AFA's private activity bond volume cap process or reporting information about the process to the AFA Board, AFA Executive Director, or the Office. For example, the AFA Board members we interviewed reported that they were not involved in nor did they oversee the AFA's private activity bond volume cap allocation process. Similarly, the AFA's Executive Director reported that he was not involved in managing the process. Finally, although the AFA is established in the Office, a Commerce Authority official responsible for overseeing Office activities reported that Office staff were not involved in the private activity bond volume cap allocation process and that it had no processes for reporting information to Office management about the fees and deposits received by the AFA for this purpose.

The AFA's lack of internal controls increases the risk for theft, loss, or misuse of private activity bond volume cap monies, which are public monies, and also resulted in the AFA failing to comply with a statutory requirement related to the monies it receives. Specifically:

- **Borrower fees and security deposits were at risk for theft, loss, or misuse—**Absent adequate separation of cash-handling duties and any monitoring and reporting requirements related to the AFA's private activity bond volume cap monies, the AFA increased the risk of theft, loss, or misuse of these monies. For example, we reviewed 6 private activity bond volume cap allocation requests—3 allocation requests the AFA received in December 2020 and 3 allocation requests the AFA received in December 2021—for which the AFA received approximately $739,000 in fees and security deposits from borrowers, primarily as checks. We found that the AFA's volume cap program manager was solely responsible for receiving and logging these checks from borrowers, inconsistent with the SAAM, which requires that 2 employees be present when mail is opened and that both employees sign a log documenting the receipt of cash and cash equivalents. Additionally, the AFA's volume cap program manager is responsible for authorizing the refund of borrower security deposits, inconsistent with the SAAM requirement that a person with responsibility for receiving cash and cash equivalents should not have responsibility for authorizing the distribution of monies. Although our review did not identify any instances of fraud, not separating these responsibilities increases the risk for theft, loss, or misuse of monies the AFA receives from borrowers.

  Additionally, in December 2019, the AFA received a $6 million letter of credit from a borrower for a security deposit related to a private activity bond volume cap allocation expiring in December 2022, at which point the AFA could have redeemed the letter of credit for cash. Although the AFA's volume cap program manager reported having stored the letter of credit in a safe since receiving it from the borrower, the AFA Board and Office management had not put processes in place requiring the AFA's volume cap program manager to report the receipt of the $6 million deposit to the AFA Board, the AFA Executive Director, the Office, or the ADOA's General Accounting Office, which is responsible for the State's financial reporting.[62] Absent any requirements to report the letter of credit to any entity charged with overseeing the AFA's monies, such as the AFA Board, the $6 million of public monies could have been misplaced or otherwise misused. As of September 2022, the bonds related to this allocation had been issued and the letter of credit was returned to the borrower.

- **AFA failed to make statutorily required transfers to the Office in fiscal years 2021 and 2022—** The monies the AFA receives related to the private activity bond volume cap allocations are deposited in the AFA's Operations Fund (see Appendix A, pages a-11 through a-12, for more information about

[62] In response to our inquiries related to this letter of credit, the ADOA's General Accounting Office adjusted the State's financial statements to account for this security deposit and indicated that it intended to update its reporting guidance for State agencies to clarify how securities such as the letter of credit received by the AFA should be reported.

the AFA's Operations Fund). Statute requires the AFA to transfer monies in its Operations Fund that are not encumbered for other purposes, such as security deposits being held for possible refund to borrowers, to the Office's Economic Development Fund at the end of each fiscal year. However, the AFA did not transfer the unencumbered monies in its Operations Fund in fiscal years 2021 and 2022, as required. Specifically, as of July 31, 2022, the AFA's Operations Fund had accumulated approximately $1 million in unencumbered monies that should have been transferred to the Office's Economic Development Fund in fiscal year 2021 or 2022, including an estimated $606,200 that the AFA should have transferred at the end of fiscal year 2021. In August 2022, during the audit and after we brought this issue to its attention, the AFA transferred all unencumbered monies in its Operations Fund to the Economic Development Fund.

As of August 2022, the Office and the AFA Board reported they were working to reassign responsibility for managing the AFA's private activity bond volume cap allocation responsibilities because the Water Infrastructure Finance Authority and its Executive Director are no longer part of the Office or overseen by the AFA Board.

- **The AIDA's operating costs in fiscal year 2021 were at least 70 percent higher than 3 other conduit issuer entities we reviewed—**We compared the AIDA's costs to operate its programs in fiscal year 2021 to the costs of 3 other conduit issuer entities and found that the AIDA's costs to operate its programs were at least 70 percent higher than the other conduit issuer entities we reviewed.[63] Specifically, in fiscal year 2021, the AIDA paid its contractor approximately $7.8 million and issued approximately $2.1 billion in bonds to finance 25 projects. We reviewed a similar conduit issuer entity in California that, similar to the AIDA, contracts for its conduit bond program operation and according to its fiscal year 2021 financial statements, it issued $2.8 billion in conduit bonds and paid its contractor approximately $4.6 million (see Figure 2, page 27). Additionally, according to the California conduit issuer entity's audited financial statements, its total operating costs for fiscal year 2021 were approximately $4.9 million, indicating that it spent approximately $3.4 million less for operating costs than the AIDA in fiscal year 2021.[64] For both the AIDA and the California conduit issuer entity we reviewed, payments to their respective contractors accounted for over 90 percent of their operating costs in fiscal year 2021, and each entity incurred additional general and administrative costs and costs for professional services.

  Additionally, we reviewed 2 other industrial development authorities in Arizona that operate their conduit bond programs with full time professional staff.[65] Specifically, Maricopa County Industrial Development Authority officials reported that the Maricopa County Industrial Development Authority employs 3.5 full-time staff and issued $396.2 million in conduit bonds in fiscal year 2021. According to its fiscal year 2021 audited financial statements, it spent approximately $778,000 to operate its programs. Phoenix Industrial Development Authority officials reported that the Phoenix Industrial Development Authority employs 13 full-time staff and issued $82.7 million in conduit bonds during fiscal year 2021. According to its fiscal year 2021 audited financial statements, it spent approximately $1.9 million to operate its programs.[66] However, the Maricopa County Industrial Development Authority and Phoenix Industrial Development Authority issued less in bonds to finance fewer projects than the AIDA, likely contributing to their lower operating costs.

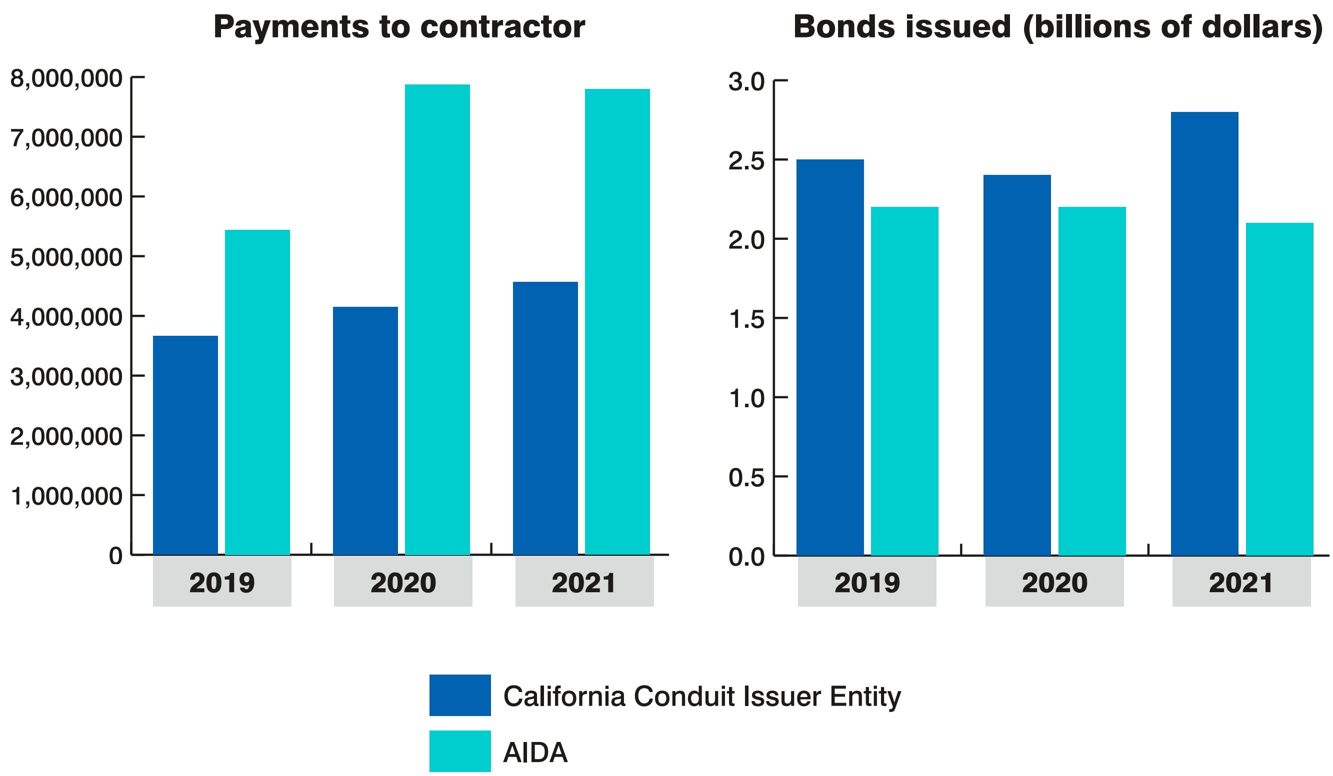
63 We reviewed 2 additional industrial development authorities in Arizona with full-time professional staff and 1 conduit issuer entity in California that contracts for operating its conduit bond program.

64 The California conduit issuer entity's total operating cost does not include distributions of issuance fees it made to municipalities or charitable donations. Specifically, this conduit issuer entity remits at least 25% of issuance fees it collects to the municipality where a project is located and donates at least 25% of issuance fees to a charity located in the municipality where a project is located. The AIDA's total operating cost does not include transfers to the State or costs it paid specifically related to its HomePlus program, such as costs for down payment assistance provided to borrowers. However, a portion of some of the costs included in the AIDA's total operating costs, such as costs for professional services and general and administrative costs, may have been incurred by the AIDA for HomePlus program matters.

65 The 2 other industrial development authorities we reviewed—Maricopa County Industrial Development Authority and Phoenix Industrial Development Authority—jointly operate a down payment assistance program similar to the AIDA's HomePlus program. The costs reported in these entities' audited financial statements represent the total operational costs incurred by these industrial development authorities to operate their respective conduit bond programs and the joint down payment assistance program.

66 The operational costs reported for these 2 industrial development authorities do not include amounts used for charitable grants to other entities.

Figure 2
Contractor payments and bond volume for AIDA and a California conduit issuer
Fiscal years 2019 through 2021



Source: Auditor General staff review of audited financial statements and AIDA conduit bond activity.

Although the AIDA does not receive State monies to pay for its operations, as previously discussed, the revenues generated by the AIDA in excess of its operating costs are statutorily required to be transferred to the State annually.[67] Additionally, the AIDA reported that 1 of its strategic objectives adopted by the AIDA Board of Directors was to maximize the revenues it transferred to the State. By ensuring the AIDA receives the maximum possible value from its contractor, the AIDA can ensure it transfers as much as possible to support the State's economic development and affordable housing efforts. For example, during fiscal years 2019 through 2021, the AIDA paid its contractor $21.1 million for operating its conduit bond program. During these years, it transferred approximately $14.2 million to the Economic Development Fund and $19.9 million to the Housing Trust Fund. If the AIDA had paid its contractor similarly to the California conduit issuer entity we reviewed, it may have been able to transfer an additional $8.7 million to support State economic development and affordable housing initiatives.

- **AFA Board had not implemented needed controls to properly manage and oversee some AIDA activities, resulting in increased risk for errors and fraud—**Statute requires the AFA Board to establish the AIDA and serve as the AIDA's board. The AIDA's corporate bylaws also established the AIDA Board of Directors consisting of the members of the AFA Board and best practices indicate that an entity's oversight body, such as its board of directors, is responsible for ensuring the entity's organizational structure is designed and implemented to enable it to effectively exercise its oversight responsibilities. However, we found that the AFA Board's lack of oversight of AIDA's activities has resulted in the AIDA being unaware of approximately $35,000 in fees that should have been paid to it and entering into a contract that required the AIDA Executive Director to approve payments to AIDA's contractor, from which he also received bonus

[67] A.R.S. §35-751(C).

payments, creating an apparent conflict of interest. Additionally, the AIDA did not have documented criteria to support its approval of conduit bond projects, increasing the risk that the AIDA Board of Directors may approve projects that do not meet its stated expectations for conduit bond projects. Finally, we recommended that the AFA Board ensure that the AIDA Board of Directors work with the AIDA Executive Director and contractor to implement a comprehensive system of internal controls for the AIDA, consistent with best practices (see Finding 1, pages 11 through 15).

- **Office lacked documentation of services received in exchange for payments made to Commerce Authority and may have allocated some costs to federal programs inconsistent with federal requirements—**The SAAM requires that expenditures of public monies must be for valid public purposes and that the cost of the goods or services should not exceed the benefit to the State. Additionally, federal regulations require that costs allocated to federal programs be in accordance with the relative benefits received by that program. However, we found that the Office did not have documentation to support that payments it made to the Commerce Authority for various services were commensurate with the benefits it received from the Commerce Authority. Additionally, the Office allocated some of these costs to programs for which it receives federal monies but, inconsistent with federal regulations, it did not have processes to track that the cost allocations were in accordance with the relative benefits received by those programs. Due to this lack of documentation, the Office could not demonstrate that its payments to the Commerce Authority for services complied with SAAM requirements for expenditures of public monies and we could not determine whether the portion of some costs it allocated to 3 federal programs complied with federal requirements. Additionally, the Office risks that at least some of the administrative and technical costs it allocated to federal programs, which total at least $330,000 for fiscal years 2020 through 2022, may be unallowable costs for which the federal government could seek repayment. Finally, we recommended that the Office should document and monitor the benefits and services the Commerce Authority provides in exchange for payments from the Office (see Finding 2, pages 16 through 18).

Recommendations

The AFA Board should:

10. Work with the AFA Executive Director and/or Office management to develop and implement internal controls consistent with the SAAM and GAO's best practices for the AFA's responsibilities related to the private activity bond volume cap allocation process. These internal controls should be documented in written policies and procedures and should include requirements and assign roles and responsibilities for:
    a. Complying with the AFA's statutory requirement to annually transfer unencumbered monies to the Economic Development Fund.
    b. Separating cash-handling responsibilities and monitoring the staff responsible for these activities, including handling and accounting for fee and security deposit monies, and regularly reporting the results of this monitoring to the AFA Board.
11. Work with the AFA Executive Director, Office management, and the ADOA's General Accounting Office to ensure that it complies with all applicable reporting requirements related to fees and security deposits received through the private activity bond volume cap allocation process.
12. Ensure the AIDA conducts an analysis of the conduit bond program's operational costs to identify potential cost savings, including, but not limited to:
    a. Evaluating if the costs of its existing contract are commensurate with the services and benefits provided by the contractor.
    b. Determining if using full-time professional staff to operate the conduit bond program could result in lower operational costs than using a contractor.
13. Ensure the AIDA uses the results of its cost analysis to take steps to ensure that the conduit bond program is operating at the lowest possible cost and that the AIDA is receiving the maximum possible value from its contractor.

14. Ensure the AFA transfers all unencumbered monies in the AFA Operations Fund at the end of each fiscal year to the Office's Economic Development Fund, as required by statute.

AFA Board response: As outlined in its **response**, the AFA Board agrees with the findings and will implement the recommendations.

Sunset factor 3: The extent to which the Office serves the entire State rather than specific interests.

The Office, including the AFA and its affiliated entities, serves the entire State by reporting on and supporting the State's workforce development efforts, producing the State's population estimates, and providing access to financing for statutorily authorized projects and financial assistance to borrowers and homebuyers across the State. Specifically, the Office:

- Provides information regarding employment and wages by industry and occupation, future employment trends, and in-demand industries and occupations for the State, counties, and several metropolitan areas.
- Supports the State's implementation of WIOA, including providing staffing support for the Workforce Arizona Council, assisting local workforce development boards in developing local workforce plans, and developing and updating the State-wide workforce plan.
- Produces the constitutionally required population estimates for the State, counties, and municipality throughout the State. The Demographer's Office also produces population projections for the State and counties 3 times per decade.
- Issues conduit bonds to finance projects throughout the State. For example, in fiscal year 2022, the AIDA issued conduit bonds for 15 projects in 7 counties in the State, including projects for charter schools, multifamily residential developments, and healthcare facilities. Additionally, as previously discussed, the AIDA is statutorily required to transfer all unencumbered monies in excess of its operating costs generated by its conduit bond program to the Office's Economic Development Fund and in fiscal year 2022, transferred approximately $2.8 million to this fund.
- Provides mortgages and down payment assistance to homebuyers throughout the State. For example, in calendar year 2021, the HomePlus program originated 5,183 mortgages with an aggregate principal of approximately $1.38 billion and provided $50.9 million of financial assistance to homebuyers across all counties in the State (see Figure 3, page 30). Additionally, in fiscal year 2022, the AIDA transferred approximately $4.2 million in unencumbered monies generated by the HomePlus program to the Housing Trust Fund, which is statutorily required to be used for developing projects and programs connected with providing housing opportunities for low- and moderate-income households and for housing affordability programs.[68]

However, the Office did not comply with some State conflict-of-interest requirements or align its conflict-of-interest process with recommended practices. Specifically:

- Although the Office reported following conflict-of-interest requirements, including requiring employees to complete a disclosure form upon hire as required by ADOA policy, the Office could not provide completed disclosure forms for any of the employees whose forms we requested. Additionally, it did not require or remind its employees to complete a new disclosure form when their circumstance changed, implement a process to review and remediate disclosed conflicts, or provide periodic conflict-of-interest training to its employees, which are recommended practices that can help ensure compliance with the State's conflict-of-interest laws. We recommended that the Office develop and implement conflict-of-interest policies and procedures to help ensure it complies with State conflict-of-interest requirements.

See Finding 3, pages 19 through 21, for additional information and recommendations.

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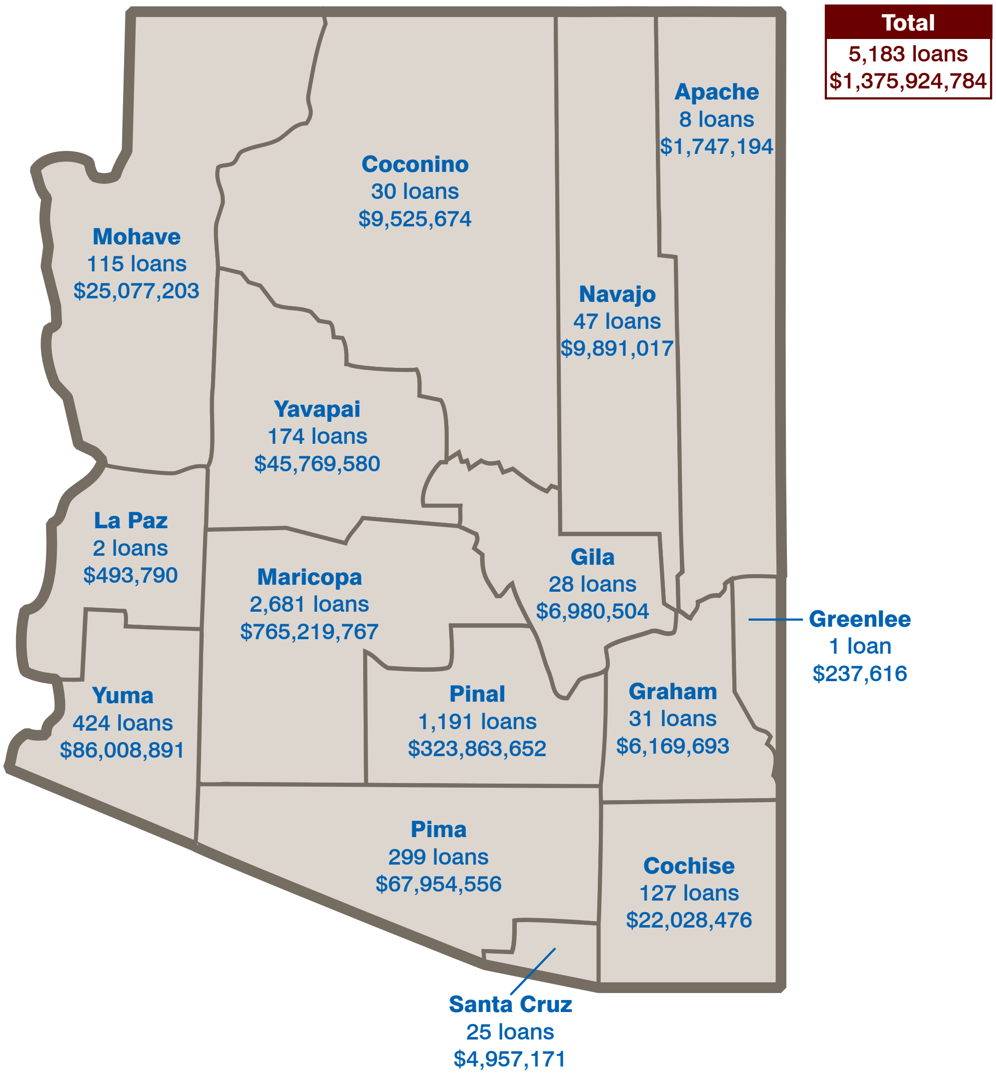
[68] A.R.S. §41-3955(C).

Figure 3
HomePlus program mortgage principal originated by county, calendar year 2021



Source: Auditor General staff review of AIDA HomePlus program activity reports.

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

Based on our review of the Office's statutes and the Arizona Administrative Code, the Office does not have the statutory authority to adopt rules and it has not done so.

A.R.S. §41-5354(10) provides the AFA with general rulemaking authority, allowing it to adopt rules consistent with its enabling statutes; however, based on our review of the AFA's statutes and Arizona Administrative Code, the AFA does not have any specific rulemaking requirements and it has not adopted any rules.[69]

[69] As noted in the Introduction (see page 4), Laws 2016, Ch. 372, §52, requires the AFA Board to serve as the governing board for the Greater Arizona Development Authority. A.R.S. §41-2255(A)(4) requires the Greater Arizona Development Authority to adopt rules establishing criteria for awarding and prioritizing technical and financial assistance to governments applying for infrastructure financing. Our review of the Greater Arizona Development Authority's rules found that prior to 2016 it had created administrative rules addressing both awarding and prioritizing technical and financial assistance.

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

The Office has not adopted rules and thus has not needed to encourage input from the public before doing so.

In addition, we attended and observed 6 public meetings held between March 2022 and May 2022—3 AFA Board meetings and 3 AIDA Board of Directors meetings—and found that the AFA and AIDA complied with the open meeting law requirements we reviewed. For example, the AFA Board and AIDA Board of Directors posted public meeting notices for each of these meetings at least 24 hours before the meetings and provided meeting recordings and/or minutes within 3 working dates after these meetings. In addition, the websites associated with these bodies include the statutorily required disclosure statement indicating where the physical and electronic locations of their public meeting notices would be posted.[70]

As discussed in the Introduction (see page 7), statute establishes the Office-supported Workforce Data Task Force to oversee the development and maintenance of the State workforce evaluation data system. However, we did not review the Data Task Force's compliance with open meeting law requirements because it did not meet during our audit.[71]

Sunset factor 6: The extent to which the Office has been able to investigate and resolve complaints that are within its jurisdiction and the ability of the agency to timely investigate and resolve complaints within its jurisdiction.

The Office does not have statutory authority or responsibility to investigate and resolve complaints. However, the Office has established a policy for investigating and resolving official challenges to population estimates produced by the Demographer's Office. Specifically, the Office has established a policy outlining a process for resolving challenges of an official population estimate by a county or municipality. According to the Office's policy, official challenges to population estimates are required to be filed within 90 calendar days of the estimates' publication by the highest elected official in the jurisdiction filing the challenge. The challenge should include information about the jurisdiction, the potential error identified, and evidence to support the jurisdiction's challenge. According to Office policy, the Demographer's Office will review the challenge, determine whether there was an error in producing the estimates, and revise the estimates as necessary. The Office reported that it had received 1 official challenge from a city disputing its official July 2019 population estimate. Our review indicated that the Office followed its policy to investigate and resolve this official challenge and the Demographer's Office revised its official population estimate for that city based on the challenge.

Sunset factor 7: The extent to which the Attorney General or any other applicable agency of State government has the authority to prosecute actions under the enabling legislation.

According to A.R.S. §41-192(A)(1), the Attorney General serves as the Office's legal advisor and provides legal services as the Office requires. Additionally, A.R.S. §41-5354(4) authorizes the AFA to hire its own legal counsel to provide legal services, and as of May 2022, the AFA had contracted with an outside law firm to provide general legal services.

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

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

[70] A.R.S. §38-431.02(A)(1)(a).

[71] Statute does not prescribe when or how often the Workforce Data Task Force should meet.

Sunset factor 9: The extent to which changes are necessary in the laws of the Office to adequately comply with the factors listed in this sunset law.

We did not identify any needed changes to the Office's statutes.

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

Terminating the Office could affect the public welfare if its responsibilities are not transferred to another entity. The Office provides information to governments, businesses, and the public about employment market conditions and future trends and supports workforce development efforts throughout the State. According to the Office, these functions can help government entities, educational institutions, and businesses in the State plan to meet future employment needs and prepare the workforce to meet those needs. Through the AFA and its related entity, the AIDA, the Office provides private borrowers with access to financing for statutorily authorized projects and homebuyers in the State with financial assistance, which may contribute to the State's economic development. The Office also fulfills some constitutionally and federally required functions for the State that would need to be transferred to other entities if the Office were terminated. For example, the Office is responsible for producing constitutionally required population estimates and, through an agreement with the Department of Economic Security, administering various labor market information programs required by the Bureau. Further, through the AFA, the Office is responsible for tracking and allocating the State's private activity bond volume cap for conduit issuers State-wide.

In addition, A.R.S. §41-3023.15 specifies that the Office cannot be terminated if it has a contractual obligation to the United States or any United States agency or any outstanding debts, obligations, or guarantees. The Greater Arizona Development Authority has approximately $7.1 million in outstanding bond debt as of June 30, 2022. If the Legislature terminated the Office, provisions would have to be made to pay or retire the Greater Arizona Development Authority's outstanding bond debt.

Finally, if the Office were terminated, including the AFA, the AIDA would continue to exist as a nonprofit corporation and political subdivision of the State. AFA officials reported that the AIDA would not have authority to issue conduit bonds without the AFA because the AFA Board is statutorily required to approve the proceedings in which conduit bonds are issued by the AIDA. However, AFA officials reported that the AIDA's HomePlus program could continue operating. Additionally, AFA officials reported that the AIDA would have the authority to engage in any other activities in which nonprofit corporations are legally permitted to engage as authorized by A.R.S. Title 10, Chapter 26.

Sunset factor 11: The extent to which the level of regulation exercised by the Office compares to other states and is appropriate and whether less or more stringent levels of regulation would be appropriate.

This sunset factor does not apply because the Office is not a regulatory agency.

Sunset factor 12: The extent to which the Office has used private contractors in the performance of its duties as compared to other states and how more effective use of private contractors could be accomplished.

The Office uses private contractors in the performance of its duties and its use of contractors is comparable to other states we reviewed. Specifically, the Office has contracted for the development and implementation of its statutorily required State workforce evaluation data system. Additionally, the Office has provided monies to the Commerce Authority to contract for specific studies related to the State tax and regulatory competitiveness. We contacted similar economic development and demographic agencies in 5 other states—California, Colorado, Nevada, Texas, and Utah—to determine the extent to which other states use private contractors. All the states we contacted reported that they did not employ private contractors for any mission-critical functions, although Utah and Colorado reported that they use private contractors for some activities, such as special projects and the development of brochures and publications.

The AFA and its related entities also use contractors in the performance of their duties, and their use of contractors is comparable to entities in other states we reviewed. Specifically, the AIDA has contracted with a private company to operate its conduit bond program and both the AFA and the AIDA have contracted with a law firm for general legal services. The AIDA's HomePlus program also contracts for mortgage servicing, selling mortgage-backed securities, and marketing. We reviewed 6 conduit issuer entities in 5 states—California, Florida, Massachusetts, Washington, and Wisconsin—to determine the extent to which other states use private contractors. Similar to the AIDA, all of the conduit issuer entities reported using contractors for various services associated with conduit bond issuances, such as legal services. Additionally, 3 conduit issuer entities we reviewed—2 in California and 1 in Wisconsin—use contractors to operate their conduit bond program similar to the AIDA.

Additionally, although the AIDA Board of Directors members we interviewed reported to us that the AIDA's contractor was primarily responsible for operating the AIDA's conduit bond program, according to the terms of its current contract which has been in effect since May 2021, the contractor does not earn its fees from the conduit bond program. Instead, the contractor earns its fees based on the production of the AIDA's HomePlus program, for which it has minimal responsibilities. For example, the AIDA Executive Director reported that he is responsible for all aspects of HomePlus program operations. He further reported that he prepares a monthly summary that he sends to the AIDA's contractor that the contractor uses to calculate its fee and to prepare AIDA Board meeting packets to update the AIDA Board on HomePlus activities. Additionally, 2 AIDA Board of Directors members we interviewed reported they understood the contractor to be responsible primarily for the conduit bond program and were not aware that the contractor's fees were based on the HomePlus program's activity.

Finally, the contract between the AIDA and its contractor in effect as of July 2022 includes a provision allowing the contractor to negotiate and collect fees directly from conduit borrowers for services related to issuing bonds and/or implementing new AIDA programs. However, the contract does not require the contractor to report to the AIDA Board of Directors how much it collects from fees paid directly to it by borrowers and, as a result, the AIDA Board of Directors has no way to track how much additional compensation the AIDA's contractor earns from these fees. Absent a process or requirement for the AIDA's contractor to report this information to the AIDA Board of Directors, it has incomplete information about the amount of compensation the AIDA's contractor earns for its services and cannot ensure that the AIDA's payments to the contractor are commensurate with the services and benefits it receives.

Recommendations

The AFA Board should ensure the AIDA:

15. In conjunction with its cost analysis, evaluates the terms of the AIDA's existing contract with its contractor, and determines whether the contractor's compensation should be based on the services it provides to the AIDA.
16. Develops and implements a process to track the number and amount of fees the AIDA's contractor collects directly from conduit borrowers, such as by including a provision in the AIDA's contract with its contractor requiring the contractor to report this information to the AIDA Board of Directors in the monthly reports it submits to the Board.

AFA Board response: As outlined in its **response**, the AFA Board agrees with the findings and will implement the recommendations.

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Question 1: What is the AIDA's conduit bond program?

Pursuant to statute, the AFA established the AIDA in 2016 as a nonprofit corporation and political subdivision of the State, and the AFA is required to serve as the AIDA's board.[72] Statute authorizes industrial development authorities established in Arizona, including the AIDA, to issue conduit bonds for the purpose of financing projects such as charter schools, healthcare facilities, multifamily housing, or any other commercial enterprise located within or outside of Arizona as long as the bond issuance provides a benefit to the State (see Question 2, pages 36 through 37, for more information on the number and types of projects the AIDA has issued conduit bonds to finance).[73] Through its conduit bond program, the AIDA

[72] A.R.S. §§41-5356(A)(1) and 35-702(A).

[73] A.R.S. §35-701 et seq. Additionally, A.R.S. §35-702 specifies the process by which an industrial development authority may be incorporated in a county or municipality, requires that each industrial development authority incorporated shall be a political subdivision of the State, and limits each county and municipality to 1 operating industrial development authority at any time.

Key terms

Conduit bond—Municipal revenue bonds issued by a conduit issuer that are purchased by a private investor for the purpose of making monies available to a borrower to finance a project.

Conduit issuer—A governmental entity, such as the AIDA, authorized to issue conduit bonds to facilitate financing between a private investor and borrower for a project.

Borrower—An entity that uses monies from the sale of conduit bonds to finance a qualifying project. Borrowers are responsible for paying conduit bond principal and interest to the private investor.

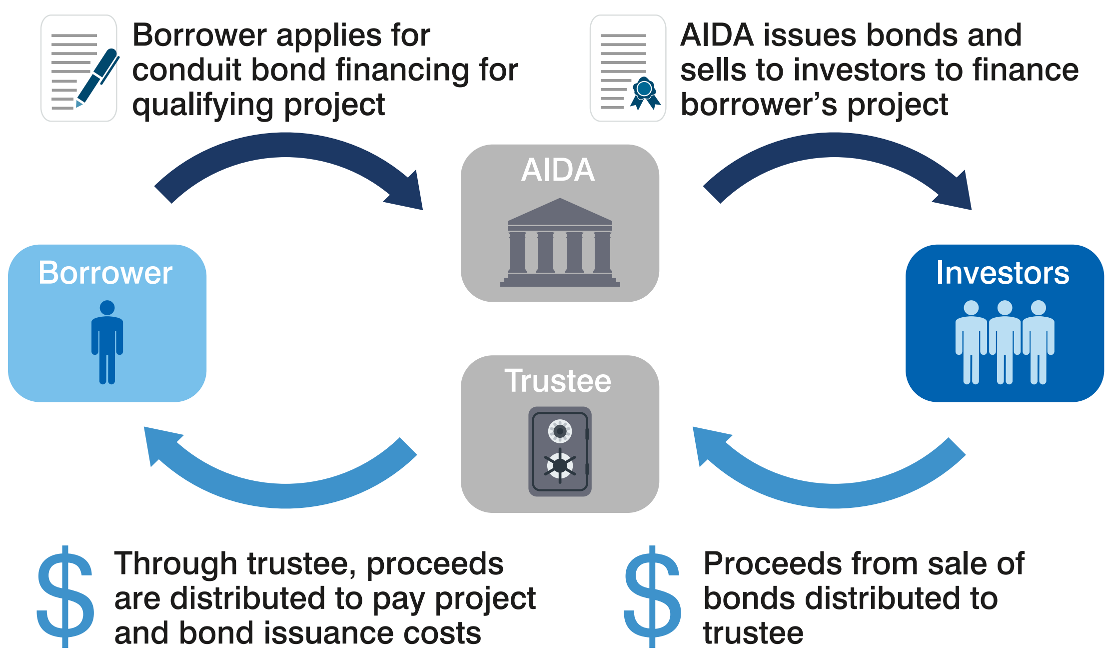
Private investor (investor)/underwriter—An investor that agrees to purchase conduit bonds to finance a borrower's project or an underwriter that agrees to conduct a public bond offering to sell bonds on behalf of the borrower.

Source: Auditor General staff review of Internal Revenue Service (IRS) guidance for conduit issuers and AIDA policy.

issues taxable and tax-exempt conduit bonds to finance projects located within and outside of Arizona (see Figure 4 for a depiction of the AIDA's conduit bond issuance process). The AIDA Board of Directors members we interviewed reported that all conduit bond projects should provide a benefit to the State and that they consider the benefit to the State when deciding whether to vote to approve projects for financing.[74] Additionally, the AIDA's contractor reported that the AIDA Board of Directors has other expectations that conduit bond projects should meet to be approved, such as having the support of the jurisdiction where the project is located (see Finding 1, page 15, for recommendations we made related to the AIDA Board of Directors' use of these criteria). The AIDA first issued conduit bonds in December 2016 when it issued approximately $31.7 million in bonds to finance an Arizona charter school, and since its inception through June 30, 2022, it had issued approximately $8.4 billion in bonds to finance 124 projects.

The AIDA does not receive State monies to operate its conduit bond program. Instead, it uses fees borrowers pay for costs to operate the conduit bond program (see Question 6, pages 41 through 42, for more information on the fees the AIDA charges borrowers). Additionally, statute requires the AIDA to annually transfer excess revenues generated by its conduit bond program to the Office's Economic Development Fund, and since its inception in 2016 through June 30, 2022, the AIDA has transferred approximately $20.4 million to this fund. The AIDA uses a contractor to administer all aspects of the conduit bond program and does not employ professional staff for this purpose.

Figure 4
AIDA's conduit bond issuance process



Source: Auditor General staff review of IRS guidance for conduit issuers and AIDA policy.

[74] Although the AIDA Board of Directors members we interviewed reported that they consider the benefit to the State when deciding whether to vote to approve projects for financing, according to an AIDA official, A.R.S. §35-706(A)(16) requires the AIDA Board of Directors to determine that issuing bonds will benefit the State only when the bonds are being issued to finance projects located outside the State.

Question 2: What types of projects is the AIDA statutorily authorized to finance through its conduit bond program, and what types of projects did it finance in fiscal years 2020 through 2022?

Statute authorizes industrial development authorities in the State, including the AIDA, to issue conduit bonds to finance certain types of projects (see textbox for statutorily authorized project types).[75] In fiscal years 2020 through 2022, the AIDA issued conduit bonds to finance 74 projects, and 66 of these projects were for educational facility projects such as charter schools, multifamily residential developments, or healthcare facility projects. Other types of projects for which the AIDA has served as conduit issuer since its inception include developing a sports complex in Arizona, a mixed-use retail complex in Idaho, and a hotel and convention center in Texas, and acquiring the rights to operate a parking system at a Michigan university. See Table 2, page 37, for the number of projects approved and dollar amount of conduit bonds the AIDA issued by project type in fiscal years 2020 through 2022.

As also seen in Table 2, in fiscal year 2022, the AIDA issued approximately $2 billion in conduit bonds to finance 25 projects. The amount of bond financing the AIDA Board of Directors approved for these 25 projects ranged from approximately $6.5 million to finance a multifamily residential development in Arizona to $238.5 million to finance 3 charter schools in New York.

Statutorily authorized project types for conduit bond financing

Statute authorizes the AIDA and other industrial development authorities to finance new or existing construction or improvements located within or outside of Arizona that are suitable for:

- Any enterprise for manufacturing, processing, or assembling agriculture or manufactured products.
- Healthcare institutions.
- Convention or trade show facilities.
- Airports, docks, wharves, mass commuting facilities, and parking facilities.
- Sewage or solid waste disposal facilities.
- Air or water pollution control facilities.
- Nonprofit educational institutions not otherwise supported by State monies.
- Research and development facilities.
- Any commercial enterprise including facilities for manufacturing, office, recreational, hotel or motel, and service uses.

Source: A.R.S. §35-701(7)(a).

The AIDA Board of Directors has also approved a conduit bond financing application requesting financing for purposes other than issuing conduit bonds. Specifically, in January 2020, the AIDA received a conduit bond financing application requesting it to facilitate a series of transactions between an investment bank and an insurance company. The investment bank sought to obtain an investment in various municipal securities from the insurance company, including municipal bonds issued by a nonprofit Arizona utility company. The investment bank requested in its conduit bond financing application that the AIDA establish a limited liability company (LLC) and, through the LLC, issue up to $500 million in credit-linked notes, which are a specific type of security that would allow the investment bank to retain some of the risk associated with the municipal securities, thereby reducing the insurance company's risk of losses related to its investment in the municipal securities.[76] The application further requested the LLC to use the proceeds from the sale of the credit-linked notes to purchase the municipal securities from the investment bank. In March 2020, the AIDA Board of Directors approved this application, and the AIDA established the LLC. Through the LLC, the AIDA issued $470 million of credit-linked notes that it sold to the insurance company and used the proceeds from the sale to purchase municipal securities from the investment bank.[77] The AIDA received a fee of approximately $1.4

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[75] A.R.S. §35-701(7).

[76] According to AIDA officials, the collateral securing the credit-linked notes issued by the AIDA's LLC are the various underlying municipal securities it purchased from the investment bank with the notes' proceeds.

[77] Industrial development authorities in Arizona, including the AIDA, are statutorily required to be established as nonprofit corporations and political subdivisions of the State. Pursuant to A.R.S. §10-3302, as a nonprofit corporation, the AIDA is statutorily authorized to engage in various activities, including incorporating other entities such as LLCs and issuing debt securities in addition to bonds.

million for facilitating these transactions and also receives an annual fee based on the aggregate amount of credit-linked notes outstanding, which it agreed to pay to a third party for accounting and advisory services (see Finding 1, page 13, for more information about the AIDA's monitoring of fee monies related to the LLC). Similar to the conduit bond debt it issues, the AIDA, the AFA, and the State have no financial liability related to the transactions executed by the AIDA's LLC, and the AIDA reported that its LLC has not engaged in any other business activities beyond facilitating the transactions between the investment bank and the insurance company.

Table 2
Number of projects approved and dollar amount of conduit bonds issued by AIDA, by project type
Fiscal years 2020 through 2022

	2020		2021		2022	
Project type	Projects	Dollar amount	Projects	Dollar amount	Projects	Dollar amount
Education	15	$935,322,076	11	$511,650,726	13	$671,356,900
Multifamily Residential	4	407,853,783	7	176,214,256	6	241,813,000
Healthcare	2	130,720,000	3	872,615,000	5	875,570,000
Commercial	2[1]	706,800,000	4	562,785,000	0	0
Manufacturing	1	22,040,000	0	0	1	199,691,759
Total	**24**	**$2,202,735,859**	**25**	**$2,123,264,982**	**25**	**$1,988,431,659**

[1] The $470 million of credit-linked notes issued by the AIDA's LLC is 1 of the 2 commercial projects listed in fiscal year 2020.

Source: Auditor General staff review of the AIDA's conduit bond project documentation.

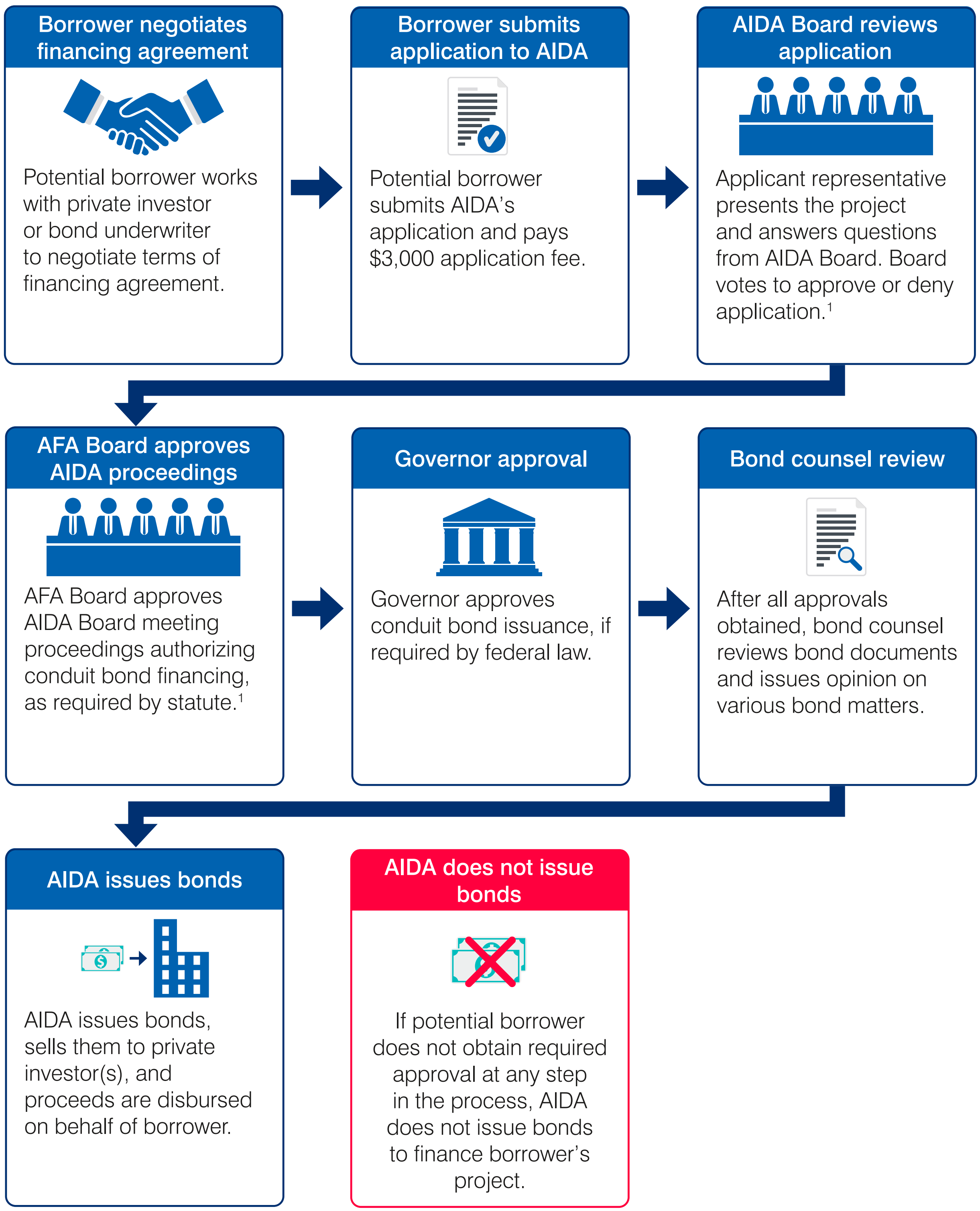
Question 3: How does a borrower apply for and receive project financing through the AIDA's conduit bond program?

As previously discussed, the AIDA does not use its own monies to finance conduit bond projects but acts as a conduit issuer to facilitate financing between a private investor/underwriter and a private borrower. As a result, before applying to the AIDA for conduit bond financing, a potential borrower must work with a private investor/underwriter to negotiate the terms of a potential financing agreement, such as expected amount of bonds to be issued, the bond maturity time frame, the expected bond rating, and whether the bond interest rate will be variable or fixed (see Figure 5, page 38, for a depiction of the AIDA's conduit bond approval process).[78]

Once the private investor/underwriter and the potential borrower have agreed to terms for a financing agreement, the potential borrower must submit a completed AIDA application for conduit bond financing with a $3,000 application fee. The AIDA's application form requires potential borrowers to provide information about its proposed financing team, such as identifying the private investor/underwriter who has tentatively agreed to purchase the conduit bonds. According to AIDA policy, potential borrowers should submit their applications at least 14 days in advance of the AIDA Board of Directors meeting at which they would like their application to be considered. Further, according to AIDA policy, a potential borrower's representative is expected to make a presentation at the AIDA Board of Directors meeting to explain the proposed project and answer questions from the AIDA Board of Directors. The AIDA Board of Directors then votes on whether to approve or deny the application for conduit bond financing (see page 38 for information on the AIDA Board of Directors' denial of applications).

[78] According to the AIDA's contractor, the AIDA has no role or responsibilities related to financing agreement negotiations between borrowers and investors/underwriters.

Figure 5
AIDA's conduit bond financing approval process



[1] Our review of meeting minutes from the AIDA Board of Directors and AFA Board meetings held since the AIDA's inception in August 2016 through July 2022 found that the AIDA Board of Directors had not denied any conduit bond projects presented to it for approval, and the AFA Board had not disapproved any AIDA proceedings authorizing conduit bond financing for projects during this time frame.

Source: Auditor General staff review of AIDA policy and A.R.S. §35-701, et seq.

If the AIDA Board of Directors approves the application, statute requires the AFA Board to approve the AIDA proceedings during which the application for conduit bond financing was approved.[79] For this approval requirement, the AFA Board, comprising the same 5 individuals as the AIDA Board of Directors, considers and votes on a resolution to approve the proceedings of the AIDA Board of Directors meeting during which the application for conduit bond financing was approved. If the AFA Board approves the resolution, and if required by federal law, the bond issuance must be submitted to the Governor for review and approval to comply with federal laws requiring public approval of private activity bonds issued by a governmental entity.[80] According to AIDA officials, the Governor approved 14 of 21 projects for which the AIDA issued conduit bonds to finance in calendar year 2021.

After obtaining all required approvals, bond counsel, who is legal counsel engaged to issue an objective legal opinion at bond issuance related to the validity of the bonds and other issues, such as the tax treatment of interest on the bonds, issues its opinion. If bond counsel issues an unqualified opinion related to various matters regarding the conduit bond issuance, the conduit bonds are issued on behalf of the AIDA and purchased by the private investor/underwriter, and the project's trustee disburses the monies resulting from the purchase for the project costs and associated issuance costs, if applicable, on the borrower's behalf. AIDA officials reported that they were unaware of any instance in which bond counsel issued a qualified opinion related to an AIDA conduit bond issuance.

Question 4: What information does the AIDA Board of Directors use when deciding whether to approve projects for conduit bond financing?

As previously discussed (see page 35), a contractor administers the AIDA's conduit bond program. For applications the contractor submits to the AIDA Board of Directors for review and approval, the AIDA's contractor prepares an informational packet provided to the AIDA Board of Directors members in advance of each Board meeting that includes information about each application for conduit bond financing on the Board meeting agenda. These packets include information about each borrower, such as its corporate structure and a summary of its business activities, and a description of the proposed project, including the locations of facilities to be acquired or developed with bond proceeds and the facilities' intended uses. These packets also include additional historical information, such as the borrower's previous conduit bond financings through the AIDA, as applicable, and the formal resolutions to be adopted by the AIDA Board of Directors to approve a project for conduit bond financing, but do not include any recommendations from the contractor related to either approving or denying the project. According to AIDA policy, a project representative is also expected to make a presentation and answer questions at the AIDA Board of Directors meeting. The AIDA Board of Directors relies on the information prepared by the contractor and presented by the project representative to decide whether to approve or deny an application for conduit bond financing. As of June 2022, the AIDA Board of Directors had never denied an application submitted to it for conduit bond financing.

The AIDA's contractor reported that it will submit to the AIDA Board of Directors for approval any application for financing a statutorily authorized project located within or outside of the State, provided that the project is not a prohibited project as defined by the contractor's intake protocols.[81] Additionally, the AIDA's contractor reported that it will not submit projects to the AIDA Board of Directors for approval if the local jurisdiction opposes the project or opposes the AIDA acting as conduit issuer.

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[79] A.R.S. §35-721(B).

[80] Pursuant to 26 CFR 1.147(f), certain private activity bonds issued by the AIDA, such as those that require an allocation from the State's private activity bond volume cap, require a public hearing and approval from an elected official of the jurisdiction approving the bond issuance. A.R.S. §35-722 authorizes the Governor, Attorney General, or the State Treasurer if designated by the Governor to approve conduit bonds issued by the AIDA pursuant to this federal requirement. According to AIDA officials, all bonds issued by the AIDA that require public approval are approved by the Governor for the purpose of complying with the federal public approval requirement.

[81] The contractor's intake protocols specify several kinds of projects that it will not submit to the AIDA Board of Directors for approval, including projects in industries with potential reputational concerns, such as the cannabis industry, projects whose applicants have a known history of fraud or financial misconduct, and projects prohibited by federal regulations.

AIDA's activities should serve public purposes

According to the AIDA's articles of incorporation, the AIDA:

- "Shall perform essential government functions and its activities shall serve public purposes and shall be in furtherance of the health, safety, and welfare of the residents of the State of Arizona."
- Was established "to promote industry and develop trade, [and] to assist, financially and otherwise, in the rehabilitation, expansion and development of all kinds of commercial enterprises which will promote and assure job opportunities and assure an improved standard of living and an increase in prosperity and health."

Source: AIDA Articles of Incorporation, dated August 9, 2016.

The AIDA's incorporation documents also identify several purposes for which it was created, including that its activities should serve public purposes and should further the health, safety, and welfare of State residents (see textbox). Additionally, as previously discussed on page 35, the AIDA Board of Directors members we interviewed reported that they consider the benefit to the State in deciding whether to approve or deny projects and that they vote to approve only projects that they believe will benefit the State. These Board of Directors members reported that a project's benefits to the State are sometimes apparent, such as when the AIDA serves as conduit issuer for a multifamily housing development in the State and the project will increase the State's housing supply. The AIDA Board of Directors members we interviewed further reported that issuing conduit bonds to finance projects, including projects located outside Arizona, provides a financial benefit to the State through the fees the AIDA collects for acting as conduit issuer (see Question 6, pages 41 through 42, for more information on the fees the AIDA receives from borrowers). However, the AIDA's policies, procedures, and conduit bond financing applications do not include requirements for information that should be submitted to the AIDA Board of Directors to assess whether projects meet their expectations or to ensure that borrowers pay all required fees (see Finding 1, pages 11 through 15, for more information).

The AIDA's contractor reported that it does not assess the credit history or financial worthiness of the borrower in deciding whether to submit a project to the AIDA Board of Directors for approval. Additionally, our review of 9 informational packets prepared by the AIDA's contractor and provided to the AIDA Board of Directors members in advance of meetings held between April 2019 and June 2022 found that the packets did not include information about the borrowers' credit history or financial worthiness. According to the AIDA's contractor, because conduit issuers facilitate financing between a borrower and a private investor/underwriter and private investors bear the financial risk in the event of a default (see Question 5 for more information), the private investor/underwriter is responsible for assessing the borrower's financial worthiness and ability to meet its repayment obligations. Additionally, the AIDA is not statutorily required to assess potential borrowers' credit history and financial worthiness. The AIDA's practice of not assessing potential borrowers' credit history or financial worthiness is consistent with 2 other industrial development authorities located in Arizona we reviewed, according to officials we interviewed from those industrial development authorities.[82]

Question 5: What is the impact to the State when a borrower defaults on its conduit bond debt obligations?

Statute prohibits industrial development authorities in the State, including the AIDA, from incurring State debt, and the conduit bonds the AIDA issues to finance projects are not State debt obligations.[83] Further, statute and AIDA policy specify that the sole source of monies for repaying conduit bonds issued by the AIDA is the revenues generated by or for the project being financed, and the conduit bonds issued by the AIDA will not

[82] We interviewed officials from the Maricopa County Industrial Development Authority and the Phoenix Industrial Development Authority, and these officials reported that their staff do not assess borrowers' credit history or financial worthiness. The Maricopa County Industrial Development Authority official reported that Maricopa County Industrial Development Authority Board members may ask financial questions of borrowers during the meetings in which borrowers' projects are being considered for approval.

[83] A.R.S. §35-723.

become debt obligations of the AIDA, the AFA, or the State.[84] The rights and responsibilities of the conduit borrowers and private investors involved with a conduit bond financing are specified in the loan agreement between the borrower and private investor, and neither the AIDA nor the State are involved with or have financial responsibility in the event a conduit borrower defaults on their obligation to repay the bonds. For example, documents we reviewed associated with 1 recent conduit bond issuance for a health facility include specific definitions of events constituting default by the borrower, as well as the specific legal remedies available to the investors in the event of a default. The remedies include demanding the borrower immediately pay total outstanding bond principal, interest, and fees and initiating civil proceedings against the borrower consistent with the terms of the legal agreement. Additionally, official documentation associated with the bond issuance includes provisions stating that nothing in the bond agreement, purchase contracts, or other documents associated with the conduit bond issuance shall be construed as obligating the AIDA, the AFA, the State, or any of its political subdivisions to pay bond principal or interest.

According to AIDA records we reviewed, and information provided by the AIDA's contractor, borrowers for 3 of 124 projects for which the AIDA issued conduit bonds to finance from its inception through June 30, 2022, have defaulted on their bond repayment obligations. Specifically:

- In September 2022, a bond trustee issued a notice of default for a borrower related to approximately $36 million in bonds the AIDA issued in 2018 to finance the acquisition of rights to operate a parking system at a Michigan university.
- In December 2021, a bond trustee issued a notice of default for a borrower related to approximately $31.2 million in bonds the AIDA issued in 2019 to finance senior living facilities in Illinois and Indiana.
- In May 2021, a bond trustee issued a notice of default for a borrower related to approximately $22 million in bonds the AIDA issued in 2019 to finance a manufacturing project in Congress, Arizona. According to bond documents, the manufacturing facility intended to utilize mining waste to produce silica-based products for consumer uses, such as soil supplements.

Additionally, in July 2021, another AIDA borrower issued notice to the bond trustee indicating that it had entered into a forbearance agreement with bondholders related to approximately $380 million of bonds the AIDA issued in 2019 to finance senior living facilities in multiple states. Although this borrower did not default on its bond obligations, according to the notice, the borrower would make repairs to the facilities the bonds financed and would not make principal and interest payments during the forbearance period.

Question 6: How does the conduit bond program generate revenue for the AIDA, and how does the AIDA use these revenues?

The AIDA receives revenues through various fees it charges to conduit borrowers for acting as the conduit issuer for their projects. These fees include:

- Application fee—Paid by each applicant when they apply for AIDA conduit bond financing and consisting of a nonrefundable fee of $3,000.
- Administrative fee—Paid by borrowers to cover administrative costs associated with their conduit bond financing transaction. Borrowers may choose to pay either an annual or 1-time fee, as follows:
    - Annual administrative fee—Paid by borrowers annually until the bond debt has been repaid. The annual administrative fee for in-State projects ranges between 0.0775 and 0.0975 percent of the outstanding aggregate principal amount of bond debt as of January 1 each year, depending on the type of borrower.[85] For projects outside the State, AIDA policy indicates that borrowers should

[84] A.R.S. §§35-721, 35-723, and 35-742.

[85] According to the AIDA's fee schedule, nonprofit and governmental borrowers pay 0.0775 percent and for-profit borrowers pay 0.0975 percent of the outstanding aggregate principal amount of bond debt as of January 1 each year for the annual administrative fee.

contact the AIDA's contractor for information. The AIDA's contractor reported that it negotiates the annual administrative fee with each borrower financing a project outside the State. Based on AIDA invoices issued to borrowers between March 2019 and April 2022 we reviewed, 2 borrowers financing projects located outside Arizona opted for the annual administrative fee and were assessed annual administrative fees of 0.0775 and 0.0465 percent of the outstanding aggregate principal amount of bond debt.

    - One-time administrative fee—Paid by borrowers in a single payment at the closing of their conduit bond financing. AIDA policy indicates that this fee is negotiated between the AIDA's contractor and the borrower (see Finding 1, page 12, for more information about the AIDA's contractor negotiating fees with borrowers). Based on AIDA records we reviewed, the 1-time administrative fee ranged from 0.2 to 0.75 percent of the total bond principal issued for the project.

- Closing fee—Paid by borrowers to the AIDA on the date the conduit bonds are issued. According to AIDA policy, the closing fee is 0.02 percent of the aggregate principal amount of conduit bonds issued. The AIDA's contractor reported that it waives the closing fee for borrowers who choose to pay the upfront administrative fee.

- State benefit fee—Paid by borrowers financing out-of-State projects. AIDA policy indicates that State benefit fees are designated for remittance to the State. According to AIDA policy, the State benefit fee amount varies based on project and transaction details and must be approved by the AIDA's contractor. Our review of AIDA invoices issued between March 2019 and April 2022 to borrowers financing out-of-State projects found that the AIDA assessed a State benefit fee for 24 out-of-State projects ranging from $5,000 to $500,000 per project. During this same time frame, AIDA borrowers paid approximately $2.2 million in State benefit fees.

- Extension fee—Paid by borrowers seeking an extension of the AIDA Board of Directors' approval for a project beyond 180 days. According to AIDA policy, approvals for applications for conduit bond financing expire after 180 days. Borrowers may seek an extension of the AIDA Board of Directors' approval by paying a $500 extension fee.

We reviewed AIDA records associated with a conduit bond issuance to finance a health facility in November 2021 and found that the borrower paid the AIDA $303,000 in total fees to issue approximately $150 million in bonds. Specifically, the borrower paid the required $3,000 application fee and a $300,000 upfront administrative fee. According to the AIDA's contractor, it waived the borrower's closing fee because the borrower chose to pay its administrative fee upfront rather than annually.

Additionally, as previously discussed, the AIDA is required to receive an annual issuer fee based on the aggregate outstanding balance of its LLC's credit linked notes. According to the financing agreement, the AIDA should annually receive 0.00375 percent of the outstanding balance of credit-linked notes (see Finding 1, page 13, for more information about the AIDA not receiving fees from its LLC's activity).

In fiscal year 2021, the AIDA collected approximately $5.4 million in borrower fees related to its conduit bond issuance activities. The AIDA uses the monies generated from these fees to pay its operating costs related to the conduit bond program, such as professional fees for legal services and payments to its contractor. As discussed in the Introduction (see page 6), any unencumbered monies in excess of the AIDA's operating costs are statutorily required to be transferred to the Office's Economic Development Fund.[86] In fiscal year 2021, the AIDA transferred approximately $6.7 million to the Office's Economic Development Fund (see Sunset Factor 2, pages 25 through 27, for more information about the AIDA's payments to its contractor and its transfers to the Economic Development Fund).

[86] A.R.S. §35-751.

Question 7: How do the AIDA's conduit bond program activities compare to other conduit issuer entities in Arizona and other states?

We reviewed 8 other conduit issuer entities to determine how the AIDA's conduit bond program activities compare to these entities and found that the AIDA's activities are similar to the other entities we reviewed, with some exceptions.[87] Specifically, similar to the AIDA, all 8 conduit issuer entities we reviewed issue conduit bonds to finance private commercial enterprises and financed a variety of commercial enterprises. Additionally, the other conduit issuer entities we reviewed were governed by a board that had authority to approve or deny applications for conduit bond financing for these entities. Finally, conduit bonds issued by all the other conduit issuer entities we reviewed were not debt obligations of their respective jurisdictions, and none of the jurisdictions incurred financial liability in the event of a borrower defaulting on bond debt obligations.

However, we also identified some differences between the AIDA and the other conduit issuer entities we reviewed. Specifically:

- Five of 8 conduit issuers we reviewed, including 2 other industrial development authorities in Arizona, operate their conduit bond programs with full-time professional staff instead of contracting for program operation. For example, the Maricopa County Industrial Development Authority and Phoenix Industrial Development Authority, which operate conduit bond programs similar to the AIDA, employ 3.5 and 13 full-time staff to operate these programs, respectively.[88] Similar to the AIDA, all the other conduit issuer entities we reviewed use contractors for various professional services associated with conduit bond issuances, such as legal services.

- Four of 8 conduit issuers we reviewed limit conduit bond issuances to projects in their jurisdictions, with some exceptions. Specifically, 3 of 6 other state conduit issuer entities we reviewed are statutorily prohibited from issuing conduit bonds to finance out-of-state projects. Additionally, although the 2 other industrial development authorities in Arizona that we reviewed are authorized to issue conduit bonds for projects in any jurisdiction, 1 of these industrial development authorities reported to us that it generally limits its activities to projects in its jurisdiction, with some exceptions. Specifically, Maricopa County Industrial Development Authority reported that if a company with a substantial presence in Maricopa County applies for conduit bond financing for a project located outside of Maricopa County, it would consider the application as long as its board determined that the project would benefit Maricopa County.

- Three of 8 conduit issuers we reviewed offer additional programs and services for businesses. For example, the Washington Economic Development Finance Authority is in the process of implementing a Small Business Technical Assistance program, which will award grants to entities that provide education, expertise, and technical assistance to Washington entrepreneurs and small businesses. Additionally, the Massachusetts Development Finance Agency offers services related to real estate development within its state, including technical assistance, development, and site readiness. Finally, the Florida Development Finance Corporation operates a clean energy program to help property owners make energy conservation and efficiency improvements to their properties.

[87] We reviewed the California Public Finance Authority, California Municipal Finance Authority, Florida Development Finance Corporation, Massachusetts Development Finance Agency, Washington Economic Development Finance Authority, Wisconsin Public Finance Authority, Maricopa County Industrial Development Authority, and Phoenix Industrial Development Authority.

[88] The Maricopa County Industrial Development Authority and Phoenix Industrial Development Authority each operate a conduit bond program and jointly operate a down payment assistance program for homebuyers.

SUMMARY OF RECOMMENDATIONS

Auditor General makes 6 recommendations to the Office and 10 recommendations to the AFA Board

The Office should:

1. Develop and implement processes to document and monitor the benefits and services that the Commerce Authority provides to the Office, including a process to track and document the time Commerce Authority staff spend on Office activities (See Finding 2, pages 16 through 18, for more information).
2. Annually evaluate and update its service agreements with the Commerce Authority to ensure that the costs it pays for Commerce Authority services are commensurate with the benefits and services it receives (See Finding 2, pages 16 through 18, for more information).
3. Ensure it complies with federal requirements for allocating costs to federal programs, including documenting that the costs it allocates to federal programs are in accordance with the benefits received by those programs (See Finding 2, pages 16 through 18, for more information).
4. Work with the Commerce Authority to develop and implement processes for establishing independence and separation between the 2 entities, consistent with their statutorily established structure as separate legal entities (See Finding 2, pages 16 through 18, for more information).
5. Develop and implement conflict-of-interest policies to help ensure compliance with State conflict-of-interest requirements, including:
    a. Requiring employees/public officers to complete a conflict-of-interest form upon hire/appointment, including attesting that no conflicts exist, if applicable.
    b. Reminding employees/public officers at least annually to update their disclosure form when their circumstances change.
    c. Storing all substantial interest disclosures, including disclosure forms and meeting minutes, in a special file available for public inspection.
    d. Establishing a process to review and remediate disclosed conflicts (See Finding 3, pages 19 through 21, for more information).
6. Develop and provide periodic training on its conflict-of-interest requirements, process, and disclosure form, including providing training to all employees and public officers on how the State's conflict-of-interest requirements relate to their unique programs, functions, or responsibilities (See Finding 3, pages 19 through 21, for more information).

The AFA Board should:

1. Ensure the AIDA Board of Directors works with the AIDA's Executive Director and contractor to develop and implement written policies and procedures documenting a comprehensive system of internal controls for the AIDA consistent with GAO's best practices. These policies and procedures should outline specific control activities, including but not limited to:

a. Outlining criteria the AIDA's contractor should use for negotiating conduit bond program fees with borrowers, including minimum and maximum fee parameters and the conditions under which fees may be waived, and developing a process to review and approve the fees negotiated by its contractor to ensure they are consistent with the criteria.

b. Implementing processes to ensure the AIDA receives all fees owed to it, including monitoring the activities of its LLC.

c. Separating responsibilities and/or implementing compensating controls for paying vendors, including ensuring that the AIDA's contractor is not responsible for executing payments to itself.

d. Reviewing invoices and supporting documentation before authorizing payment to vendors (see Finding 1, pages 11 through 15, for more information).

2. Reassign responsibilities or implement compensating controls to eliminate the AIDA Executive Director's competing interests related to approving payments to the AIDA's contractor (see Finding 1, pages 11 through 15, for more information).

3. Ensure the AIDA Board of Directors documents its criteria for approving conduit bond projects for financing and requiring applicants to provide information about how their projects meet these criteria (see Finding 1, pages 11 through 15, for more information).

4. Work with the AFA Executive Director and/or Office management to develop and implement internal controls consistent with the SAAM and GAO's best practices for the AFA's responsibilities related to the private activity bond volume cap allocation process. These internal controls should be documented in written policies and procedures and should include requirements and assign roles and responsibilities for:

   a. Complying with the AFA's statutory requirement to annually transfer unencumbered monies to the Economic Development Fund.

   b. Segregating cash-handling responsibilities and monitoring the staff responsible for these activities, including handling and accounting for fee and security deposit monies, and regularly reporting the results of this monitoring to the AFA Board (See Sunset Factor 2, pages 22 through 29, for more information).

5. Work with the AFA Executive Director, Office management, and the ADOA's General Accounting Office to ensure that it complies with all applicable reporting requirements related to fees and security deposits received through the private activity bond volume cap allocation process (See Sunset Factor 2, pages 22 through 29, for more information).

6. Ensure the AIDA conducts an analysis of the conduit bond program's operational costs to identify potential cost savings, including, but not limited to:

   a. Evaluating if the costs of its existing contract are commensurate with the services and benefits provided by the contractor.

   b. Determining if using full-time professional staff to operate the conduit bond program could result in lower operational costs than using a contractor (See Sunset Factor 2, pages 22 through 29, for more information).

7. Ensure the AIDA uses the results of its cost analysis to take steps to ensure that the conduit bond program is operating at the lowest possible cost and that the AIDA is receiving the maximum possible value from its contractor (See Sunset Factor 2, pages 22 through 29, for more information).

8. Ensure the AFA transfers all unencumbered monies in the AFA Operations Fund at the end of each fiscal year to the Office's Economic Development Fund, as required by statute (See Sunset Factor 2, pages 22 through 29, for more information).

9. Ensure the AIDA, in conjunction with its cost analysis, evaluates the terms of the AIDA's existing contract with its contractor, and determines whether the contractor's compensation should be based on the services it provides to the AIDA (See Sunset Factor 12, pages 32 through 33, for more information).

10. Ensure the AIDA develops and implements a process to track the number and amount of fees the AIDA's contractor collects directly from conduit borrowers, such as by including a provision in the AIDA's contract with its contractor requiring the contractor to report this information in its monthly report to the AIDA Board of Directors (See Sunset Factor 12, pages 32 through 33, for more information).

APPENDIX A

Summary of Office and AFA administered funds

This appendix provides summary financial information for Office and AFA administered funds, including the Greater Arizona Development Authority's fund, for fiscal years 2020 through 2022.[89] The Office and the AFA separately administer and manage their applicable funds. Additionally, because the AIDA is a nonprofit corporation and political subdivision of the State, its activities are not recorded in the State's accounting system and a fund accounting system is not applicable; therefore, the activity is not included in this appendix. However, see Appendix B, pages b-1 through b-3, for information on the AIDA's cash receipts and disbursements for fiscal years 2020 through 2022.

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[89] As discussed in the Introduction (see page 1), effective September 24, 2022, Laws 2022, Ch. 366, removed the Water Infrastructure Finance Authority from the Office, created the Water Infrastructure Finance Authority Board, and transferred responsibility for overseeing the Water Infrastructure Finance Authority from the AFA Board to the Water Infrastructure Finance Authority Board; therefore, the Water Infrastructure Finance Authority's funds are not included in this appendix.

Office funds

The Office has 5 funds that it used to account for its operations. Each fund has different revenue sources and permitted uses of fund monies. Although some of the funds have general permitted uses, such as to further the Office's mission and related economic development interests, others have external restrictions that guide the permitted uses such as the Federal Grants Fund and Intergovernmental and Interagency Services Fund.

Economic Development Fund

The Office's Economic Development Fund is established by A.R.S. §41-5302 and is not subject to appropriation. The fund is used to account for monies received from the AFA and the AIDA in accordance with A.R.S. §§41-5352(D) and 35-751(C), and the expenditures of those monies for economic development projects approved by the Office's Director. As shown in Table 3, the Economic Development Fund had revenues of approximately $7.7, $6.7, and $2.8 million in fiscal years 2020, 2021, and 2022, respectively. As also shown in Table 3, the Office did not expend any of these monies in fiscal year 2020; however, it paid approximately $2.1 and $3.4 million in fiscal years 2021 and 2022, respectively, to the Commerce Authority for services and reimbursements related to an agreement to provide various services such as account-based marketing, supply chain development, and elevation of next-generation technologies in support of growing and expanding Arizona's economy.

Table 3
Schedule of Economic Development Fund revenues, expenditures, and changes in fund balance
Fiscal years 2020 through 2022
(Unaudited)

	2020	2021	2022
Revenues			
Statutorily required remittances			
AIDA[1]	$7,499,097	$6,732,430	$2,800,901
AFA's Operations Fund[2]	257,000		
Total revenues	**7,756,097**	**6,732,430**	**2,800,901**
Expenditures			
Commerce Authority charges and reimbursements – professional and outside services[3]		2,184,582	3,424,935
Total expenditures	**0**	**2,184,582**	**3,424,935**
Net change in fund balance	7,756,097	4,547,848	(624,034)
Fund balance, beginning of year	1,261,010	9,017,107	13,564,955
Fund balance, end of year	**$9,017,107**	**$13,564,955**	**$12,940,921**

1 Statutorily required transfers from the AIDA were received in accordance with A.R.S. §35-751(C). The AIDA's transfers to the Economic Development Fund in fiscal year 2020 included approximately $3.2 million for the AIDA's fiscal year 2019 activity transferred after fiscal year end in July 2019. According to the AIDA, the amount transferred in fiscal year 2022 decreased because it collected less in issuer fees from its conduit bond activities.

2 Statutorily required transfers from the AFA were received in accordance with A.R.S. §41-5352(D). However, the AFA did not make the statutorily required transfer in fiscal years 2021 or 2022 (see Sunset Factor 2, pages 25 through 26, for additional information about the AFA not making statutorily required transfers to the Economic Development Fund).

3 Commerce Authority charges and reimbursements for fiscal year 2021 were paid to the Commerce Authority in accordance with an interagency service agreement to provide up to $5.5 million for various services such as providing account-based marketing, supply chain development, and elevation of next-generation technologies in support of growing and expanding Arizona's economy.

Source: Auditor General staff analysis of the Arizona Financial Information System *Accounting Event Transaction File* for fiscal years 2020 through 2022, and the State of Arizona *Annual Financial Report* for fiscal years 2020 and 2021.

Federal Grants Fund

The Office's Federal Grants Fund is allowed by A.R.S. §35-131(H) and is not subject to appropriation. The fund is used to account for federal grant monies the Office receives, which are restricted for specific uses based on the federal grant program requirements. As shown in Table 4, page a-4, the Federal Grants Fund had federal grant revenues of approximately $1.9, $2.7, and $2.5 million in fiscal years 2020, 2021, and 2022, respectively. The monies were received from the U.S. Departments of Labor, Transportation, and Education, including the following U.S. Department of Labor grants:

- Labor Force Statistics program that provides funding to collect, analyze, and publish labor-related statistical data such as employment and unemployment, labor demand and turnover, wages, and earnings data.
- Employment Services/Wagner-Peyser Funded Activities program that provides funding for a variety of services to bring together individuals looking for employment and employers looking for job seekers.
- WIOA Youth Activities program that provides funding to help low-income youth between the ages of 14 and 24 acquire the educational and occupational skills, training, and support needed to achieve academic and employment success and successfully transition into careers and productive adulthood.

As also shown in Table 4, page a-4, the Federal Grants Fund's expenditures in fiscal years 2020 through 2022 included expenditures paid directly to outside vendors and those paid to the Commerce Authority for services performed or for reimbursements to the Commerce Authority for expenditures the Commerce Authority incurred on behalf of the Office. The expenditures included paying for employee payroll and related benefits; travel; various operating expenditures such as rent and information technology-related costs; and computer equipment and software. The types and amounts of expenditures varied each fiscal year based on the amount and purpose of grant monies received each year.

Table 4
Schedule of Federal Grants Fund revenues, expenditures, and changes in fund balance Fiscal years 2020 through 2022
(Unaudited)

	2020	2021	2022
Revenues			
Federal grants	**$1,914,471**	**$2,655,099**	**$2,496,166**
Expenditures and transfers			
Office directly paid expenditures			
Payroll and related benefits	1,692,875	1,967,550	1,780,938
Professional and outside services	22,373	9,032	2,135
Travel	26,244	425	876
Other operating			
Information technology-related	51,215	61,586	85,690
Accounting, budgeting, and financial services	34,133	4,638	
Telecommunication	15,626	23,221	13,455
Other[1]	30,041	25,888	24,845
Total other operating	131,015	115,333	123,990
Computer equipment and software	21,219	362	58,266
Transfers to other State agencies			300
Total Office directly paid expenditures and transfers	1,893,726	2,092,702	1,966,505
Commerce Authority charges and reimbursements[2]			
Professional services	168,059	211,917	194,586
Return Stronger Upskilling Partnership		200,000	
Other operating			
Rent	83,037	92,917	146,317
Information technology-related	6,516		5,280
Software	2,408		
Total Commerce Authority charges and reimbursements	260,020	504,834	346,183
Total expenditures and transfers	**2,153,746**	**2,597,536**	**2,312,688**
Net change in fund balance	(239,275)	57,563	183,478
Fund balance, beginning of year	137,613	(101,662)	(44,099)
Fund balance, end of year[3]	**$(101,662)**	**$(44,099)**	**$139,379**

1 This category includes various expenditures such as dues, employee tuition reimbursements, supplies, postage and delivery, and insurance costs and these costs vary from year to year depending on program needs and other factors. For example, the Office paid approximately $3,300 for dues in fiscal years 2020 and 2022; however, it paid approximately $18,600 for dues in fiscal year 2021, including approximately $15,300 paid to the National Governors Association (NGA) Center for Best Practices. According to its website, the NGA Center is a research development firm and directly services the nation's governors to develop innovative solutions to pressing public policy challenges.

2 Commerce Authority charges and reimbursements were for services provided by the Commerce Authority, such as administrative and technical support, and reimbursements for expenditures the Commerce Authority incurred on behalf of the Office. For example:

- Professional and outside services primarily consisted of administrative and technical support services charges and costs related to the Office's website.
- Return Stronger Upskilling Partnership expenditures consisted of a contribution paid to the Commerce Authority for the creation of a new website as part of a collaboration with the Office, the Commerce Authority, other State agencies, and ARIZONA@WORK, a public and private partnership.
- Rent expenditures included the amount charged for housing the Office in the Commerce Authority's building.

3 Timing differences occur when federal monies are received and when they are spent; consequently, deficit balances occurred between fiscal years. Specifically, federal grants are often established on a reimbursement basis, meaning the Office would be required to expend the money prior to receiving a reimbursement, thereby creating a deficit balance for the grant.

Source: Auditor General staff analysis of the Arizona Financial Information System *Accounting Event Transaction File* for fiscal years 2020 through 2022, and the State of Arizona *Annual Financial Report* for fiscal years 2020 and 2021.

Office’s Operations Fund

The Office’s Operations Fund is established by A.R.S. §41-5302 for the furtherance of the Office’s mission and related economic development interests and is continuously appropriated, meaning the fund receives its revenues independent of any appropriation from the Legislature. The fund received $2.1, $2.2, and $2.9 million in fiscal years 2020, 2021, and 2022, respectively, primarily from filing and registration fees collected by the Arizona Corporation Commission and remitted to the Office in accordance with various statutes.

As also shown in Table 5, page a-6, fund expenditures in fiscal years 2020 through 2022 included paying for employee payroll and related benefits; professional and outside services; various operating expenditures such as rent and information technology-related costs; and computer equipment and software. In fiscal year 2021, approximately $1.6 million of these expenditures were payments to the Commerce Authority related to a workforce training center located at Central Arizona College.

Table 5
Schedule of the Office's Operations Fund revenues, expenditures, and changes in fund balance
Fiscal years 2020 through 2022
(Unaudited)

	2020	2021	2022
Revenues			
Filing fees and registration[1]	$2,072,632	$2,118,507	$2,058,047
Federal grants[2]		98,755	875,893
Other		2,774	
Total revenues	**2,072,632**	**2,220,036**	**2,933,940**
Expenditures and transfers			
Office directly paid expenditures			
Payroll and related benefits	285,013	200,601	195,131
Professional and outside services[3]	196,826	472,679	353,296
Travel	8,130	51	22
Other operating			
Information technology-related[4]	184,846	135,457	888,765
Accounting, budgeting, and financial services	533	3,983	2,500
Telecommunication	12,288	1,786	601
Other	25,177	6,457	12,705
Total other operating	222,843	147,683	904,571
Computer equipment	20,672	714	15,061
Transfers to other State agencies[5]			59,382
Total Office directly paid expenditures and transfers	733,484	821,728	1,527,463
Commerce Authority charges and reimbursements[6]			
Professional services	536,367	700,163	419,631
CAC workforce training center		1,586,253	
Other operating			
Rent	353,589	130,850	45,766
Information technology-related	7,448	5,400	
Software		976	
Total Commerce Authority charges and reimbursements	897,404	2,423,642	465,397
Total expenditures	**1,630,888**	**3,245,370**	**1,992,860**
Net change in fund balance	441,744	(1,025,334)	941,080
Fund balance, beginning of year	2,016,040	2,457,784	1,432,450
Fund balance, end of year	**$2,457,784**	**$1,432,450**	**$2,373,530**

1 Filing and registration fees are monies collected by the Arizona Corporation Commission and remitted to the Office in accordance with various statutes. For example, A.R.S. §44-1861(C) required payment of a nonrefundable registration fee on the aggregate offering price of securities sold in the State and up to $500 of the fee is allocated to the Office.

2 Federal grants revenues in fiscal year 2021 were monies passed through the Governor's Office from the WIOA Adult federal program to reimburse the Office for a portion of the State's workforce evaluation data system expenditures. This federal program's purpose is to serve individuals and help employers meet their workforce needs by providing them with job search assistance and training opportunities.

3 Other professional and outside services expenditures include various external services including legal, temporary agency, and cloud hosting-related services.

4 Information technology related expenditures in fiscal years 2020 and 2021 primarily consisted of payments to the Department of Economic Security that, according to the Office, were for the Department of Economic Security's support of the State's workforce evaluation data system project as previously discussed (see Introduction, page 3, for additional information). In addition, fiscal year 2022 included $683,000 that was paid for cloud hosting-related expenditures.

Table 5 continued

[5] Transfers to other State agencies in fiscal year 2022 were transfers to the Arizona Department of Education for services it performed related to the State's workforce evaluation data system project.

[6] Commerce Authority charges and reimbursements were for services provided by the Commerce Authority and reimbursements for expenditures the Commerce Authority incurred on behalf of the Office. For example:

- Professional and outside services primarily consisted of administrative and technical support and research services provided by the Commerce Authority.
- Central Arizona College workforce training center expenditures in fiscal year 2021 were reimbursements to the Commerce Authority for a workforce training center located at Central Arizona College. The Commerce Authority and the Office entered an interagency service agreement whereby the Office agreed to pay up to $1.65 million toward the center's project costs, including design and construction of the new training facility.
- Rent expenditures were primarily the amount charged for housing the Office in the Commerce Authority building and in fiscal year 2020, according to Commerce Authority officials, the Office paid higher rent charges because it moved into the Commerce Authority offices and was charged for the costs of modifying the Commerce Authority space to accommodate the Office.

Source: Auditor General staff analysis of the Arizona Financial Information System *Accounting Event Transaction File* for fiscal years 2020 through 2022, and the *State of Arizona Annual Financial Report* for fiscal years 2020 and 2021.

General Fund

The Office's General Fund is an appropriated fund supported by State General Fund appropriations that accounts for expenditures of those appropriations. As shown in Table 6, during fiscal years 2020 and 2021, the Office also collected a total of approximately $20,200 that was from the U.S. Census Bureau to reimburse the State for a portion of the Demographer's Office's payroll and benefits and other related expenditures. Consequently, the monies were remitted to the State General Fund. As also shown in Table 6, fund expenditures in fiscal years 2020 through 2022 primarily paid for employee payroll and related benefits and various operating expenditures, such as Commerce Authority rental charges and information technology-related costs.

Table 6
Schedule of General Fund revenues and expenditures
Fiscal years 2020 through 2022
(Unaudited)

	2020	2021	2022
Revenues			
State General Fund appropriations	$510,489	$478,989	$467,208
Federal grants[1]	15,352	4,856	
Total gross revenues	525,841	483,845	467,208
Remittances to the State General Fund[1]	(15,352)	(4,856)	
Total net revenues	**$510,489**	**$478,989**	**$467,208**
Expenditures			
Office directly paid expenditures			
Payroll and related benefits	$445,714	$436,231	$452,277
Professional and outside services	56	11	
Travel	1,786		
Other operating			
Information technology-related	6,331	8,518	7,140
Accounting, budgeting, and financial services	5,333	1,379	
Telecommunication	1,222	1,886	640
Other	1,005	814	201
Total other operating	13,891	12,597	7,981
Computer and telecommunication equipment	460	53	6,950
Total Office directly paid expenditures	461,907	448,892	467,208
Commerce Authority charges and reimbursements[2]			
Professional services	4,548	4,071	
Other operating - rent	44,034	26,026	
Total Commerce Authority charges and reimbursements	48,582	30,097	0
Total expenditures	**$510,489**	**$478,989**	**$467,208**

[1] Federal grant revenues were reimbursements from the U.S. Census Bureau to pay a portion of the Demographer's Office's payroll, benefits, and other related expenditures, initially paid by the Office's General Fund, that were remitted to the State General Fund.

[2] Commerce Authority charges and reimbursements were for services provided by the Commerce Authority, such as administrative and technical support, and reimbursements for expenditures Commerce Authority incurred on behalf of the Office. Specifically, professional services for both fiscal years 2020 and 2021 were primarily for administrative and technical support services provided by the Commerce Authority. In addition, Commerce Authority rent charges were the amounts charged for housing the Office in the Commerce Authority building; however, the rent reported in the table for fiscal year 2020 related to rent expenditures the Office incurred in fiscal year 2019. Additionally, the Office's General Fund was not charged any rent for fiscal years 2020 and 2022, and instead the Office's Operations Fund paid for Office rent expenses.

Source: Auditor General staff analysis of the Arizona Financial Information System *Accounting Event Transaction File* for fiscal years 2020 through 2022, and the State of Arizona *Annual Financial Report* for fiscal years 2020 and 2021.

Intergovernmental and Interagency Services Fund

The Office's Intergovernmental and Interagency Services Fund is a fund allowed by A.R.S. §35-131(H) and is not subject to appropriation. The fund is used to account for intergovernmental revenues from the Office's agreements with other State agencies. Specifically, as shown in Table 7, page a-10, during fiscal years 2020, 2021, and 2022, the Office received approximately $558,300, $107,900, and $222,200, respectively, from agreements with State agencies such as the following:

- An agreement with the Arizona Department of Transportation to improve demographic and employment data analyses for the State that, in part, would benefit transportation planning. Some of the monies were paid from the U.S. Department of Transportation's Highway Planning and Construction federal program. The agreement included payment for the salary and related benefits for the Office's State Demographer and/or staff members of the Demographer's Office, up to $70,000 annually. In fiscal years 2020 through 2022, the Office received approximately $70,000, $50,000, and $67,000, each year from this agreement.

- An agreement with the Arizona Department of Education to provide the Office with research services and data reports that reflect various labor market formulas to assist the Arizona Department of Education in the analysis of certain economic measures such as high demand and high wage occupations. In fiscal year 2021, the Office received $10,000 from this agreement.

- An agreement with the Governor's Office to provide monies for the Arizona Career Readiness Credential initiative from the WIOA federal monies. Specifically, the Office participated in the Governor's Arizona Career Readiness Credential initiative where the Governor partnered with ARIZONA@WORK and the Office to make a tool available to job seekers to prepare them for their success. In fiscal years 2020 and 2022, the Office received approximately $445,000 and $50,000, respectively, from this agreement.

As also shown in Table 7, page a-10, in fiscal years 2020 through 2022, the fund paid for various purposes including employee payroll and related benefits, software support and maintenance costs, and software purchases. For example, in fiscal year 2020, the Office paid approximately $438,000 for software related to its participation in the Governor's Arizona Career Readiness Credential initiative that provided a tool for job seekers (see Table 7, footnotes 1 and 2, page a-10, for additional information).

Table 7

Schedule of Intergovernmental and Interagency Services Fund revenues, expenditures, and changes in fund balance
Fiscal years 2020 through 2022
(Unaudited)

	2020	2021	2022
Revenues			
Intergovernmental[1]	**$558,263**	**$107,871**	**$222,184**
Expenditures			
Payroll and related benefits		48,235	68,188
Professional and outside services	500		
Travel	1,534	8	
Other operating – software support and maintenance	44,017	43,877	45,205
Software[2]	437,670		
Total expenditures	**483,721**	**92,120**	**113,393**
Net change in fund balance	74,542	15,751	108,791
Fund balance, beginning of year	61,422	135,964	151,715
Fund balance, end of year	**$135,964**	**$151,715**	**$260,506**

1 Intergovernmental revenues included federal grant monies passed through other State agencies. For example, the Office received monies from the WIOA program that passed through the Governor's Office, and the U.S. Department of Transportation's Highway Planning and Construction program that passed through the Arizona Department of Transportation.

2 Software expenditures in fiscal year 2020 were for the purchase of skill assessment software related to the Governor's Arizona Career Readiness Credential initiative.

Source: Auditor General staff analysis of the Arizona Financial Information System *Accounting Event Transaction File* for fiscal years 2020 through 2022, and the State of Arizona *Annual Financial Report* for fiscal years 2020 and 2021.

AFA funds

The AFA has 2 funds, 1 used to account for its operations and 1 used to account for the Greater Arizona Development Authority's activities that the AFA oversees.[90] The AFA and the Greater Arizona Development Authority are component units of the State of Arizona because they are legally separate entities for which the State is considered to be financially accountable, or they raise and hold economic resources for the direct benefit of the State. Because the AIDA is a nonprofit corporation and political subdivision of the State, its activities are not recorded in the State's accounting system (see Appendix B, Table 11, pages b-1 through b-3, for the AIDA's financial information). Both AFA funds have different revenue sources and permitted uses of those monies.

AFA Operations Fund

The AFA's Operations Fund is established by A.R.S. §41-5352 and is continuously appropriated to the AFA to pay for its operations. As shown in Table 8, page a-12, the fund had revenues of approximately $271,000, $327,000, and $392,000 in fiscal years 2020, 2021, and 2022, respectively. The revenues were primarily from application and confirmation fees from borrowers who applied to a local industrial development authority to issue private activity bonds to finance a qualifying project.

As also shown in Table 8, page a-12, the AFA expended approximately $1,400 and $1,500 in fiscal years 2020 and 2021, respectively, primarily for insurance costs. Additionally, Table 8, page a-12, shows the AFA had a fiscal year 2022 ending fund balance of approximately $1 million; however, these monies were owed to the Economic Development Fund, and in August 2022, the AFA transferred these monies to the Economic Development Fund.

Further, as shown in Table 9, page a-13, the AFA received security deposits from borrowers related to the AFA's private activity bond volume cap allocation process (see Introduction, page 6, for more information). Although these monies were recorded in the AFA Operations Fund, these monies were not revenues and, therefore, were not reported in Table 8. As also shown in Table 9, the amount of security deposits the AFA held at the end of fiscal year 2022 was $8.5 million, with $6 million in the form of a letter of credit that was returned in September 2022, because the bonds to finance the borrower's project were issued before its allocation expired.

[90] As discussed in the Introduction (see page 1), effective September 24, 2022, Laws 2022, Ch. 366, removed Water Infrastructure Finance Authority from the Office, created the Water Infrastructure Finance Authority Board, and transferred responsibility for overseeing Water Infrastructure Finance Authority from the AFA Board to the Water Infrastructure Finance Authority Board; therefore, the Water Infrastructure Finance Authority funds are not included in this appendix.

Table 8
Schedule of AFA's Operations Fund revenues, expenditures, and changes in fund balance Fiscal years 2020 through 2022
(Unaudited)

	2020	2021	2022
Revenues			
Application and confirmation fees[1]	$268,529	$297,935	$285,567
Forfeited security deposits[2]		23,000	93,200
Interest on investments	2,964	5,635	12,809
Total revenues	**271,493**	**326,570**	**391,576**
Expenditures and transfers			
Payroll and related benefits	258	424	
Other operating - insurance	1,100	1,100	
Total expenditures	1,358	1,524	0
Transfers to the Office's Economic Development Fund[3]	257,000		
Total expenditures and transfers	**258,358**	**1,524**	**0**
Net change in fund balance	13,135	325,046	391,576
Fund balance, beginning of year	268,056	281,191	606,237
Fund balance, end of year[4]	**$281,191**	**$606,237**	**$997,813**

1 Application and confirmation fees were the fees assessed to borrowers who applied to a local industrial development authority for a private activity bond issuance that required an allocation from the State's private activity bond volume cap. Specifically, in accordance with A.R.S. §35-903, the AFA was authorized to assess a nonrefundable application fee of $1,000. In accordance with A.R.S. §35-909, the AFA was required to assess a nonrefundable confirmation fee equal to $320 per million dollars of allocated private activity bond volume cap.

2 Amounts were the security deposits forfeited by borrowers when the bonds to finance their projects were not issued before their allocations or any associated extension expired or the total amount of bonds issued did not use the full volume cap allocation (see Table 9, footnote 3, page a-13, for additional information).

3 Transfers to the Economic Development Fund were made in accordance with A.R.S. §41-5352(D). However, the AFA did not make the statutorily required transfers in fiscal years 2021 or 2022 (see Sunset Factors, pages 25 through 26, for additional information). The AFA transferred approximately $1 million to the Economic Development Fund in August 2022.

4 The AFA's ending fund balance in fiscal year 2022 was owed to the Economic Development Fund (see Sunset Factors, pages 25 through 26, for additional information). In addition, this amount does not include security deposits from borrowers that applied to a local industrial development authority for a private activity because these monies are not revenues to the AFA Operations Fund and are instead considered deposits held for others, unless they are forfeited and then become the AFA's revenues (see footnote 2).

Source: Auditor General staff analysis of the Arizona Financial Information System *Accounting Event Transaction File* for fiscal years 2020 through 2022, the State of Arizona *Annual Financial Report* for fiscal years 2020 and 2021, and AFA-provided information.

Table 9
Schedule of AFA's security deposits received, refunded, and changes in deposits held
Fiscal years 2020 through 2022
(Unaudited)

	2020	2021	2022
Security deposits received			
Cash		$2,767,933	$5,152,000
Letter of credit[1]	$6,000,000		
Security deposits refunded[2]	(83,450)	(1,299,540)	(3,994,193)
Forfeited security deposits[3]		(23,000)	(93,200)
Net change in security deposits	5,916,550	1,445,393	1,064,607
Security deposits held, beginning of year	83,450	6,000,000	7,445,393
Security deposits held, end of year	**$6,000,000**	**$7,445,393**	**$8,510,000**

1 The AFA also held a $6 million letter of credit as a security deposit for a project with a private activity bond volume cap allocation expiring in December 2022. As of September 2022, the bonds were issued and the letter of credit was returned to the borrower (see Sunset Factors, page 25 for additional information).

2 Security deposits were refunded to the borrower if private activity bonds were issued to finance their projects before their private activity bond volume cap allocation or associated extension expired.

3 Amounts were security deposits forfeited to the AFA in fiscal years 2021 and 2022, respectively, pursuant to A.R.S. §§35-906(B)(3) and 35-910(C) because the borrowers' private activity bond volume cap allocations or any associated extension expired before the private activity bonds were issued to finance their projects or the bonds issued to finance the borrowers' projects did not use the full volume cap allocation.

Source: Auditor General staff analysis of the Arizona Financial Information System *Accounting Event Transaction File* for fiscal years 2020 through 2022, and AFA-provided information.

Greater Arizona Development Authority funds

As discussed in the Introduction (see page 6), the Greater Arizona Development Authority was created to provide financial and technical assistance to local and tribal governments and special districts with the development of public infrastructure. The Greater Arizona Development Authority has not issued any new bonds for these entities since 2010 and issued a refunding bond in 2014 to refinance older bonds. As of June 30, 2022, the Greater Arizona Development Authority had $7.1 million of outstanding bond obligations on behalf of 8 cities and towns and 1 fire district.

Greater Arizona Development Authority Revolving Fund

The Greater Arizona Development Authority's Revolving Fund is established by A.R.S. §41-2254 and is not subject to appropriation. The fund is used to account for the operating activities of the Greater Arizona Development Authority. As shown in Table 10, the Greater Arizona Development Authority received approximately $244,700, $70,200, and $42,200 in fiscal years 2020, 2021 and 2022, respectively, from investment income. As also shown in Table 10, the Greater Arizona Development Authority expended $24,800 each year for administrative expenditures in fiscal years 2020 through 2022. The Greater Arizona Development Authority had a fund balance of approximately $12.9 million on June 30, 2022, with nearly $12 million of the balance held as pledged security funds related to its bond issuances.

Table 10
Schedule of Greater Arizona Development Authority's Revolving Fund revenues, expenditures, and changes in fund balance[1]
Fiscal years 2020 through 2022
(Unaudited)

	2020	2021	2022
Revenues			
Investment income	**$244,680**	**$70,208**	**$42,229**
Expenditures			
Administrative	**24,800**	**24,800**	**24,800**
Net change in fund balance	219,880	45,408	17,429
Fund balance, beginning of year	12,570,077	12,789,957	12,835,365
Fund balance, end of year[2]	**$12,789,957**	**$12,835,365**	**$12,852,794**

1 The table includes those monies that are deposited and expended from the Greater Arizona Development Authority's fund; therefore, it does not include monies from local Arizona cities, towns, and fire districts that were deposited into bond-related bank accounts outside of the State Treasurer. Specifically, the Greater Arizona Development Authority entered into agreements that required these entities to pay the Greater Arizona Development Authority the amount of principal and interest required each year on the bonds and these monies are not accounted for on the State's accounting system. For example, according to information received from Water Infrastructure Finance Authority staff responsible for administering the Fund, in fiscal years 2020, 2021 and 2022, approximately $16.8, $0.5, and $2.7 million, respectively, was paid by these entities to the bond-related bank accounts to pay for principal on the outstanding bonds.

2 Ending fund balance includes nearly $12 million that were held as pledged security funds related to the Greater Arizona Development Authority's bond issuances.

Source: Auditor General staff analysis of the Arizona Financial Information System *Accounting Event Transaction File* for fiscal years 2020 through 2022, and the State of Arizona *Annual Financial Report* for fiscal years 2020 and 2021.

AIDA cash receipts, cash disbursements, and changes in cash and cash equivalents

This appendix provides information on cash receipts, cash disbursements, and changes in cash for the AFA's related entity the AIDA for fiscal years 2020 and 2021, and estimated activity for fiscal year 2022. As discussed in the Introduction (see pages 4 through 5), statute required the AFA Board to establish the AIDA as a nonprofit corporation and political subdivision of the State and serve as the board for the AIDA.

As also discussed in the Introduction (see page 5), the AIDA issues taxable and tax-exempt conduit bonds to finance statutorily authorized projects and administers the HomePlus program. As shown in Table 11 (see page b-2 through b-3), the AIDA's cash receipts were approximately $65.9 million and $69.4 million in fiscal years 2020 and 2021, respectively, and are estimated to be more than $66 million in fiscal year 2022. These receipts were primarily received from the sale of mortgage-backed securities.

As also shown in Table 11, page b-2, the AIDA's cash disbursements were more than $71 million each year during fiscal years 2020 and 2021 and are estimated to be nearly $53 million in fiscal year 2023, primarily for down payment assistance provided to borrowers through the HomePlus program. Further, at the end of fiscal year 2022, the AIDA's estimated ending cash balance was approximately $15.8 million, which included $15 million that was encumbered for down payment loans through the HomePlus program (see Introduction, pages 5 through 6, for more information about the HomePlus program's down payment loans).

Table 11
Schedule of AIDA cash receipts, disbursements, and changes in cash
Fiscal years 2020 through 2022
(Unaudited)

	2020 (Actual)	2021 (Actual)	2022 (Estimate)
Cash receipts			
Sale of mortgage-backed securities[1]	$57,217,398	$61,713,008	$63,163,396
Bond issuer services[2]	7,606,818	5,439,155	2,860,773
Line of credit drawdowns[3]	899,684	2,206,747	
Investments	85,757	33,724	37,115
Other	68,042		
Total cash receipts	**65,877,699**	**69,392,634**	**66,061,284**
Cash disbursements			
Down payment assistance[4]	44,078,937	44,871,608	37,898,649
Transfers to the State of Arizona[5]	19,355,276	14,734,379	7,001,910
Line of credit payments[3]		3,106,431	
Community Reinvestment Act program[6]	7,766	59,406	
Administrative			
Management fees[7]	7,877,622	7,794,989	6,709,698
Professional fees	376,913	394,694	890,790
Payroll and related benefits	162,427	199,707	281,837
Sales and marketing	42,049	88,152	95,367
General and administrative	53,463	77,279	82,907
Interest		4,294	28
Other	7,642	2,196	
Total administrative	8,520,116	8,561,311	8,060,627
Total cash disbursements	**71,962,095**	**71,333,135**	**52,961,186**
Increase (decrease) in cash	(6,084,396)	(1,940,501)	13,100,098
Cash, beginning of year	10,735,311	4,650,915	2,710,414
Cash, end of year[8]	**$4,650,915**	**$2,710,414**	**$15,810,512**

1 Sale of mortgage-backed securities receipts were monies generated from selling mortgages originated through the HomePlus program in the form of mortgage-backed securities to generate the revenues the AIDA uses to provide forgivable financial assistance (see pages 5 through 6 for additional information).

2 Bond issuer services receipts were monies generated from fees and reimbursements from borrowers the AIDA received for activities related to the issuance of conduit bonds for statutorily authorized projects (see pages 41 through 42 for additional information). The bond proceeds and payment of principal and interest are not included in this table as the obligations are obligations of the private users and not AIDA obligations. (See pages 40 through 41 for additional information.)

3 Line of credit drawdowns receipts were monies received from a revolving line of credit the AIDA opened in July 2019. The monies could only be used to pay for Community Reinvestment Act eligible, nonforgivable second mortgage loans that were pledged to secure the related drawdown. The Community Reinvestment Act program required the U.S. Federal Reserve and other federal banking regulators to encourage financial institutions to help meet the credit needs of the communities in which they do business, including low- and moderate-income neighborhoods. The AIDA received a total of approximately $3.1 million. In May 2021, the AIDA paid off and closed the line of credit.

4 Down payment assistance cash disbursements were monies from the sale of mortgage-backed securities receipts that were used to provide loans and down payment assistance as part of the HomePlus program (see footnote 1).

5 Transfers to the State of Arizona were monies transferred to the Arizona Department of Housing's Housing Trust Fund and the Office's Economic Development Fund in accordance with A.R.S. §35-751(C). Transfers in fiscal year 2020 included approximately $7.5 million the AIDA transferred to the Housing Trust Fund and the Economic Development Fund for fiscal year 2019 activity because the AIDA made these transfers in July 2019. According to the AIDA, the amount transferred to the State of Arizona in fiscal year 2022 decreased because it collected less in issuer fees from its conduit bond activities.

Table 11 continued

[6] Community Reinvestment Act program cash disbursements were related to a line of credit that allowed the AIDA to pay for Community Reinvestment Act-eligible, nonforgivable second mortgage loans (see footnote 3, page b-2, for additional information).

[7] Management fee disbursements were paid to the AIDA's conduit bond program contractor that managed the activities and administrative affairs of the AIDA and was responsible for all costs and expenses in connection with the conduit bond and HomePlus programs. The contractor and the AIDA entered into a new contract effective May 1, 2021, that reduced the types of fees and the percentage of each fee the contractor was entitled to and transferred the responsibility for paying all expenses associated with operating the conduit bond and HomePlus programs to the AIDA.

[8] Fiscal year 2022 ending cash balance included $15 million that was encumbered for down payment loans through the HomePlus program (see Introduction, pages 5 through 6, for more information about the HomePlus program's down payment loans) and, according to the AIDA, any monies not spent for this program by the end of fiscal year 2023 will be transferred to the State of Arizona (see footnote 5, page b-2, for information about required transfers to the State of Arizona).

Source: Auditor General staff analysis of the AIDA's fiscal years 2020 and 2021audited financial statements and AIDA-provided information for fiscal years 2020 through 2022.

APPENDIX C

Scope and methodology

The Arizona Auditor General has conducted this performance audit and sunset review of the Office pursuant to a December 17, 2020, resolution of the Joint Legislative Audit Committee. The audit was conducted as part of the sunset review process prescribed in A.R.S. §41-2951 et seq.

We used various methods to address the audit's objectives. These methods included reviewing applicable State statutes and federal laws and regulations; federal grant agreements; and the Office's policies and procedures; interviewing Office and AFA staff and AFA Board members; and reviewing information from the Office's website. In addition, we used the following specific methods to meet the audit objectives:

- To determine whether the Office's expenditures complied with applicable requirements, we reviewed the applicable statutory, SAAM, contractual, or federal grant requirements to determine permissible uses of Office monies, and the Office's expenditure-related policies and procedures. We also reviewed a judgmental sample of 105 of 1,827 Office expenditure transactions for professional and outside services, other operating expenditures, and noncapital purchases from July 1, 2019 through March 31, 2022, and assessed whether these expenditure transactions complied with applicable requirements. The sample of expenditure transactions we reviewed totaled approximately $6.9 million, representing 73 percent of professional and outside services, other operating expenditures, and noncapital purchases the Office incurred during this time frame. The sample included 93 expenditure transactions, totaling approximately $6 million, that were payments to the Commerce Authority pursuant to various interagency service agreements the Office entered with the Commerce Authority.

- To assess the AFA Board's oversight and implementation of internal control procedures for the AIDA's activities, we reviewed AIDA's articles of incorporation and corporate bylaws, policies and procedures, vendor payment processes, and monitoring activities for its LLC, and compared them against GAO recommended practices for internal controls, recommended practices for nonprofit entity boards of directors, and applicable statutory requirements.[91] Additionally, we judgmentally selected and reviewed the meeting agendas, minutes, and associated Board meeting packets for 9 AIDA Board of Directors meetings held between April 2019 and June 2022 to assess the AIDA's process for reviewing and approving conduit bond financing applications and assessing the associated benefits to the State.

- To determine whether the AIDA paid its contractor in accordance with contract terms, we judgmentally selected and reviewed 7 AIDA monthly payments to its conduit bond program contractor in fiscal years 2020 through 2022, totaling approximately $4.8 million, and reviewed the associated contracts and supporting documentation related to these payments.

[91] U.S. Government Accountability Office. (2014). *Standards for internal control in the federal government*. Washington, DC. Retrieved 4/6/2022 from https://www.gao.gov/assets/gao-14-704g.pdf.; and National Council of Nonprofits. (n.d.) *Board roles and responsibilities*. Washington, DC. Retrieved 7/26/2022 from https://www.councilofnonprofits.org/tools-resources/board-roles-and-responsibilities.

- To assess the Office's compliance with State conflict-of-interest requirements and alignment with recommended practices, we reviewed statute and ADOA requirements, the AFA's conflict-of-interest policies and procedures and conflict-of-interest disclosure form, and recommended practices.[92,93]

- To assess whether the AFA transferred unencumbered monies in its Operations Fund as required by statute and evaluate the timeliness in processing private activity bond volume cap applications, we reviewed the AFA's financial activity for fiscal years 2020 through 2022. Additionally, we randomly selected and reviewed 6 private activity bond volume cap allocation requests for which the AFA confirmed volume cap allocations—3 of 13 requests for which the AFA confirmed volume cap allocations in December 2020, and 3 of 13 requests for which the AFA confirmed volume cap allocations in December 2021.

- To obtain information about the AIDA's conduit bond program, we reviewed the AIDA's articles of incorporation, corporate bylaws, and policies and procedures; interviewed AIDA staff and the AIDA's contractor; and reviewed documentation related to AIDA conduit bond issuances. In addition, we reviewed IRS guidance for conduit issuer entities.[94] To obtain information about other conduit issuer entities, we judgmentally selected and reviewed 8 conduit issuer entities—6 in other states, including California, Washington, Massachusetts, Wisconsin, and Florida, and 2 in Arizona.[95]

- To obtain information for the Introduction, we reviewed Office-provided information regarding Office and Board member vacancies as of August 2022. Additionally, to obtain information for the Introduction and Appendix A, we compiled and analyzed unaudited financial information from the AFIS *Accounting Event Transaction File* for fiscal years 2020 through 2022 and the State of Arizona *Annual Financial Report* for fiscal years 2020 and 2021.

- To obtain information for Appendix B, we compiled and analyzed the AIDA's audited financial statements for fiscal years 2020 and 2021 and unaudited financial information from the AIDA's accounting records for fiscal year 2022.

- To obtain additional information for the Sunset Factors, we judgmentally selected 1 conduit issuer entity in California and 2 other industrial development authorities in Arizona and reviewed their audited financial statements and websites to compare their activities and operational costs to those of the AIDA. To determine the extent to which the Office and AFA served the entire State, we reviewed the AIDA's HomePlus program activity for calendar year 2021. To assess the AFA's and its related entities' compliance with various provisions of the State's open meeting law, we observed 6 public meetings—3 AFA Board meetings and 3 AIDA Board of Directors meetings held between March and May 2022. To assess the Office's use of contractors, we judgmentally selected and contacted 8 entities responsible for various Office functions in 5

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[92] Recommended practices we reviewed included: Organization for Economic Cooperation and Development. (2022). *Recommendation of the Council on OECD guidelines for managing conflicts of interest in the public service*. Paris, France. Retrieved 5/25/2022 from https://legalinstruments.oecd.org/public/doc/130/130.en.pdf; Ethics & Compliance Initiative. (2016). *Conflicts of interest: An ECI benchmarking group resource*. Arlington, VA. Retrieved 5/25/2022 from https://www.ethics.org/knowledge-center/conflicts-of-interest-report/; and Controller and Auditor General of New Zealand (2020). *Managing conflicts of interest: A guide for the public sector*. Wellington, New Zealand. Retrieved 5/25/2022 from https://oag.parliament.nz/2020/conflicts/docs/conflicts-of-interest.pdf.

[93] In response to conflict-of-interest noncompliance and violations investigated in the course of our work, we have recommended several practices and actions to various school districts, State agencies, and other public entities. Our recommendations are based on guidelines developed by public agencies to manage conflicts of interest in government and are designed to help ensure compliance with State conflict-of-interest requirements. See, for example, Arizona Auditor General reports 21-402 *Higley Unified School District—Criminal Indictment—Conspiracy, Procurement Fraud, Fraudulent Schemes, Misuse of Public Monies, False Return, and Conflict of Interest*, 19-105 *Arizona School Facilities Board—Building Renewal Grant Fund*, and 17-405 *Pine-Strawberry Water Improvement District—Theft and misuse of public monies*.

[94] IRS. (2019). *Your responsibilities as a conduit issuer of tax-exempt bonds* (IRS publication 5005). Washington, DC: U.S. Department of the Treasury. Retrieved 5/4/2022 from https://www.irs.gov/pub/irs-pdf/p5005.pdf.

[95] We selected the conduit issuer entities in other states based on publicly available information about the scope and nature of these entities' activities. Specifically, we selected entities with conduit bond issuance activities similar to and different from the AIDA, including entities that issued bonds for out-of-state projects, entities with statutory limitations on the types of projects eligible for funding, and entities with activities or programs in addition to the conduit bond financing activities. We selected the 2 industrial development authorities in Arizona because they issue conduit bonds for statutorily authorized projects similar to the AIDA and jointly operate a down payment assistance program similar to the AIDA's HomePlus program.

states—California, Colorado, Nevada, Texas, and Utah—and reviewed their use of private contractors.[96] To assess the AFA's use of contractors, including for AIDA's conduit bond program, we judgmentally selected 6 conduit issuer entities in 5 states—California, Florida, Massachusetts, Washington, and Wisconsin—and reviewed their use of private contractors for mission-critical activities.[97]

Our work on internal controls included reviewing the Office's and AFA's policies and procedures for ensuring compliance with statues and various federal requirements, and, where applicable, testing its compliance with these policies and procedures. Our internal control work included reviewing the following components of internal controls: control environment, control activities, and monitoring. We reported our conclusions on internal control deficiencies in Findings 1 through 3, and in our responses to the statutory sunset factors.

We selected our audit samples to provide sufficient evidence to support our findings, conclusions, and recommendations. Unless otherwise noted, the results of our testing using these samples were not intended to be projected to the entire population.

We conducted this performance audit of the Office in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We express our appreciation to the Office and its staff and the AFA Board and its staff for their cooperation and assistance throughout the audit.

[96] We selected these states because they are western states and because the Office considers these states to be regional economic competitors with Arizona.

[97] We reviewed these states' use of private contracts for mission-critical activities in conjunction with obtaining information about their conduit issuer entity activities.

OFFICE RESPONSE

Douglas A. Ducey
Governor

Sandra Watson
Director

ARIZONA OFFICE OF ECONOMIC OPPORTUNITY

100 NORTH 7TH AVENUE, SUITE 400
PHOENIX, ARIZONA 85007

September 27, 2022

Lindsey A. Perry
Auditor General
Office of the Auditor General
2910 N. 44th St., Ste. 410
Phoenix, AZ 85018

RE: Performance Audit and Sunset Review of the Office of Economic Opportunity

Dear Ms. Perry:

The responses of the Office of Economic Opportunity (the “OEO”) to the findings and recommendations of the Final Performance Audit of the OEO are attached.

We again extend our thanks to the Auditor General team for its efforts during the Sunset Review process.

Sincerely,

Sandra Watson
Director

Finding 2: Office lacked documentation of services received in exchange for payments made to Commerce Authority and may have allocated some of these costs to federal programs inconsistent with federal requirements

Recommendation 1: Develop and implement processes to document and monitor the benefits and services that the Commerce Authority provides to the Office, including a process to track and document the time Commerce Authority staff spend on Office activities.

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

Response explanation: The Office believes that the benefits and services provided to it by the Commerce Authority were commensurate with the costs it paid to the Commerce Authority. The Office will work with the Commerce Authority to develop and implement a process to document and monitor in greater detail the benefits and services that the Commerce Authority provides to the Office.

Recommendation 2: Annually evaluate and update its service agreements with the Commerce Authority to ensure that the costs it pays for Commerce Authority services is commensurate with the benefits and services it receives.

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

Response explanation: The Office will develop a process to annually evaluate and update its service agreements with the Commerce Authority to ensure that the costs it pays for Commerce Authority services is commensurate with the benefits and services it receives.

Recommendation 3: Ensure it complies with federal requirements for allocating costs to federal programs, including documenting that the costs it allocates to federal programs are in accordance with the benefits received by those programs.

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

Response explanation: The Office will review Federal guidelines and work with Federal partners to ensure cost allocations are properly reported and documented.

Recommendation 4: Work with the Commerce Authority to develop and implement processes for establishing independence and separation between the 2 entities, consistent with their statutorily established structure as separate legal entities.

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

Response explanation: The Office will work with the Commerce Authority to develop policies and procedures to better document and ensure the independence and separation between the two entities.

Finding 3: Office did not comply with a key State conflict-of-interest requirement, increasing risk that employees and public officers had not disclosed substantial interests that might influence or could affect their official conduct

Recommendation 5: Develop and implement conflict-of-interest policies to help ensure compliance with State conflict-of-interest requirements, including:

Recommendation 5a: Requiring employees/public officers to complete a conflict-of-interest form upon hire/appointment, including attesting that no conflicts exist, if applicable.

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

Response explanation: The Office will further develop conflict-of-interest policies and procedures to ensure compliance, including ensuring employees /public officers complete conflict-of-interest forms upon hire/appointment.

Recommendation 5b: Reminding employees/public officers at least annually to update their disclosure form when their circumstances change.

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

Response explanation: The Office will implement a procedure for soliciting updated disclosures from employees/public officials, at least annually.

Recommendation 5c: Storing all substantial interest disclosures, including disclosure forms and meeting minutes, in a special file available for public inspection.

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

Response explanation: The Office will implement a process for identifying and storing substantial disclosures in a special file for public inspection.

Recommendation 5d: Establishing a process to review and remediate disclosed conflicts.

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

Response explanation: The Office will establish a process for review and remediation of disclosed conflicts.

Recommendation 6: Develop and provide periodic training on its conflict-of-interest requirements, process, and disclosure form, including providing training to all employees and public officers on how the State’s conflict-of-interest requirements relate to their unique programs, functions, or responsibilities.

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

Response explanation: The Office will develop and provide all employees with periodic training on its conflict-of-interest requirements process and disclosure form, including providing training to all employees and public officers on how the State’s conflict-of-interest requirements relate to their unique programs, functions, or responsibilities.

AFA BOARD RESPONSE

DOUGLAS A. DUCEY
Governor

GARY J. NAQUIN
Chairman

DIRK SWIFT
Director

Arizona Finance Authority
100 N. 7th Ave, Suite 130 | Phoenix, Arizona 85007 | www.azfinanceauthority.com

September 28, 2022

VIA ELECTRONIC MAIL ONLY

Lindsey A. Perry
Auditor General
Office of the Auditor General
2910 North 44th Street, Suite 410
Phoenix, Arizona 85018

Dear Ms. Perry,

Thank you for the opportunity to respond to the information relevant to the Arizona Finance Authority (AFA) contained in your Office's recent performance audit of the Arizona Office of Economic Opportunity. As we previously discussed, the AFA Board appreciates the thorough review and helpful recommendations contained in the final performance review. Attached please find AFA's formal responses to the report. The AFA plans to promptly begin addressing identified issues and we look forward to sharing our progress at the agency's 6-month follow-up.

Sincerely,

Gary J. Naquin, Chairman
Arizona Finance Authority

Attachment

Finding 1: AFA Board had not implemented needed controls to properly manage and oversee some AIDA activities, resulting in increased risk for errors and fraud

Recommendation 1: The AFA Board should ensure the AIDA Board of Directors works with AIDA's Executive Director and contractor to develop and implement written policies and procedures documenting a comprehensive system of internal controls for the AIDA consistent with GAO's best practices. These policies and procedures should outline specific control activities, including but not limited to:

Recommendation 1a: Outlining criteria the AIDA's contractor should use for negotiating conduit bond program fees with borrowers, including minimum and maximum fee parameters and the conditions under which fees may be waived, and developing a process to review and approve the fees negotiated by its contractor to ensure they are consistent with the criteria.

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

Response explanation: The AFA Board will ensure the AIDA Board of Directors works with AIDA's Executive Director and contractor to develop and implement written policies and procedures documenting a comprehensive system of internal controls for the AIDA consistent with GAO's best practices, which will outline criteria the AIDA's contractor should use for negotiating conduit bond program fees with borrowers, and may include minimum and maximum fee parameters, will delineate the conditions under which fees may be waived, and will develop a process to review and approve the fees negotiated by its contractor to ensure they are consistent with the criteria.

Recommendation 1b: Implementing processes to ensure the AIDA receives all fees owed to it, including monitoring the activities of its LLC.

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

Response explanation: The AFA Board will ensure the AIDA Board of Directors works with AIDA's Executive Director and contractor to develop and implement written policies and procedures documenting a comprehensive system of internal controls for the AIDA consistent with GAO's best practices, which will outline processes to ensure the AIDA receives all fees and monies owed to it, including monitoring the activities of its LLC, and providing regular summaries of fees charged/received to the AIDA Board.

Recommendation 1c: Separating responsibilities and/or implementing compensating controls for paying vendors, including ensuring that the AIDA's contractor is not responsible for executing payments to itself.

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

Response explanation: The AFA Board will ensure the AIDA Board of Directors works with AIDA's Executive Director and contractor to develop and implement written policies and procedures documenting a comprehensive system of internal controls for the AIDA consistent with GAO's best practices, including separating responsibilities and/or implementing compensating controls for paying vendors, including ensuring that the

AIDA's contractor is not responsible for executing payments to itself. The AIDA Executive Director or appropriate delegate will authorize the wire transfer of the contractor's monthly payment to the contractor's bank account.

Recommendation 1d: Reviewing invoices and supporting documentation before authorizing payment to vendors.

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

Response explanation: The AFA Board will ensure the AIDA Board of Directors works with AIDA's Executive Director and contractor to develop and implement written policies and procedures documenting a comprehensive system of internal controls for the AIDA consistent with GAO's best practices, which will include a requirement that invoices and supporting documentation be reviewed (including supporting documentation, if applicable) before authorizing payment to vendors. The AIDA Executive Director, board officer or appropriate delegate will review and approve payment of vendor invoices.

Recommendation 2: The AFA Board should reassign responsibilities or implement compensating controls to eliminate the AIDA Executive Director's competing interests related to approving payments to the AIDA's contractor.

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

Response explanation: The AFA Board will ensure that the AIDA Board and the AIDA Executive Director amend the Executive Director's employment contract to eliminate any actual or perceived competing interests, in particular, any discretionary payment from the AIDA's contractor.

Recommendation 3: The AFA Board should ensure the AIDA Board of Directors documents its criteria for approving conduit bond projects for financing and requiring applicants to provide information about how their projects meet these criteria.

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

Response explanation: The AFA Board will ensure the AIDA Board, the AIDA Executive Director and the AIDA's contractor work together to document the AIDA's criteria for approving conduit bond projects for financing and require applicants to provide information about how their projects meet these criteria recommends, which will include, among other things, (i) continued engagement by the AIDA Board of legal counsel to advise as to whether a project to be considered by the AIDA Board is eligible for bond financing under statute, (ii) requiring the contractor to continue charging a "State Benefit Fee" for each out-of-state financing to ensure the statutory requirement of the financing providing a benefit to the state is met, and (iii) possible revisions to the AIDA's Procedural Pamphlet, Bond Financing Application, and/or Board Memo format to further highlight these features.

Sunset Factor 2: The extent to which the AFA Board has met its statutory objective and purpose and the efficiency with which it has operated.

Recommendation 4: The AFA Board should work with the AFA Executive Director and/or Office management to develop and implement internal controls consistent with GAO's best practices for the AFA's responsibilities related to the private activity bond volume cap allocation process. These internal controls should be documented in written policies and procedures and should include requirements and assign roles and responsibilities for:

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

Response explanation: The AFA Board will work with the AFA Executive Director and/or Office management to develop and implement internal controls consistent with GAO's best practices with respect to the AFA's responsibilities to receive volume cap-related fees and security deposits in the form of written policies and procedures, including assigning roles and responsibilities, if applicable, for consideration and adoption by the AFA Board. The method of allocation of volume cap itself is set forth in statute and will continue to be followed.

Recommendation 4a: Complying with the AFA's statutory requirement to annually transfer unencumbered monies to the Economic Development Fund.

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

Response explanation: The written policies and procedures referenced in Response explanation 4 above will assign responsibility to a specific person/people to confirm the required transfer is made each year.

Recommendation 4b: Separating cash handling responsibilities and monitoring the staff responsible for these activities, including handling and accounting for fee and security deposit monies, and regularly reporting the results of this monitoring to the AFA Board.

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

Response explanation: The AFA Executive Director will work with OEO to develop and implement internal controls consistent with GAO's best practices with respect to the AFA's responsibility for handling and accounting for volume cap-related fee and security deposit monies. Status updates on volume cap fees/security deposits/refunds will be provided to the AFA Board not less than twice per year.

Recommendation 5: The AFA Board should work with the AFA Executive Director, Office management, and ADOA's General Accounting Office to ensure that it complies with all applicable reporting requirements related to fees and security deposits received through the private activity bond volume cap allocation process.

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

Response explanation: To date all checks deposited by AFA and wires received by AFA with respect to volume cap fees and security deposits have been deposited into the AFA's Operations Fund with the State Treasurer's Office and accounted for in AFIS. The AFA Board will work with the AFA Executive Director, Office management, and ADOA's

General Accounting Office to ensure that it complies with all applicable reporting requirements related to fees and security deposits received through the private activity bond volume cap allocation process.

Recommendation 6: The AFA Board should ensure the AIDA conducts an analysis of the conduit bond program's operational costs to identify potential cost savings, including, but not limited to:

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

Response explanation: The AFA Executive Director will recommend to the AFA Board and the AIDA Board engagement of an independent third-party to review operational costs of the AIDA's conduit bond program to identify potential cost savings.

Recommendation 6a: Evaluating if the costs of its existing contract are commensurate with the services and benefits provided by the contractor.

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

Response explanation: The AFA Executive Director will recommend to the AFA Board and the AIDA Board engagement of an independent third-party to review operational costs of the AIDA's conduit bond program, including an analysis of the contractor's function and cost vs. benefits and results of services provided.

Recommendation 6b: Determining if using full-time professional staff to operate the conduit bond program could result in lower operational costs than using a contractor.

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

Response explanation: The AFA Executive Director will recommend to the AFA Board and the AIDA Board engagement of an independent third-party to review operational costs of the AIDA's conduit bond program, including an evaluation of whether the use of full-time professional staff could result in lower operational costs than using a contractor and what, if any, expected effect such a change would have on revenues to be generated for the state.

Recommendation 7: The AFA Board should ensure the AIDA uses the results of its cost analysis to take steps to ensure that the conduit bond program is operating at the lowest possible cost and that the AIDA is receiving the maximum possible value from its contractor.

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

Response explanation: The AFA will ensure the AIDA Board considers the results of the independent third-party review of operational costs of the AIDA's conduit bond program vs. relative value/benefit received to ensure the conduit bond program is operated by the contractor at the lowest possible cost in order to generate the highest possible revenues for the state.

Recommendation 8: The AFA Board should ensure the AFA transfers all unencumbered monies in the AFA Operations Fund at the end of each fiscal year to the Office's Economic Development Fund, as required by statute.

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

Response explanation: The AFA Executive Director will work with OEO to develop and implement internal controls consistent with GAO's best practices to ensure unencumbered monies are transferred to OEO's Development Fund at the end of each fiscal year.

Sunset Factor 12: The extent to which the AFA Board has used private contractors in the performance of its duties as compared to other states and how more effective use of private contractors could be accomplished.

Recommendation 9: The AFA Board should ensure the AIDA, in conjunction with its cost analysis, evaluates the terms of the AIDA's existing contract with its contractor, and determines whether the contractor's compensation should be based on the services it provides to the AIDA.

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

Response explanation: The AFA will ensure the AIDA Board considers the results of the independent third-party review of operational costs of the AIDA's conduit bond program vs. benefit received and evaluate the source of the contractor's compensation based on the services it provides to the AIDA.

Recommendation 10: The AFA Board should ensure AIDA develops and implements a process to track the number and amount of fees the AIDA's contractor collects directly from conduit borrowers, such as by including a provision in the AIDA's contract with its contractor requiring the contractor to report this information in its monthly report to the AIDA Board of Directors.

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

Response explanation: The AFA Executive Director will recommend to the AIDA Board that it develop and implement a process to track the number and amount of fees the AIDA's contractor collects directly from conduit borrowers, including reports to the Board of such results on a monthly or other regular periodic basis.

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