A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Procedural Review

Commission for the Deaf and the Hard of Hearing

As of May 10, 2002

STATE OF ARIZONA
OFFICE OF THE
AUDITOR
GENERAL

Debra K. Davenport
Auditor General

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STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

February 11, 2003

Sherri L. Collins, Executive Director
State of Arizona
Commission for the Deaf and the Hard of Hearing
1400 West Washington Street, Room 126
Phoenix, AZ 85007

Dear Ms. Collins:

We have performed a procedural review of the Commission's internal controls in effect as of May 10, 2002. Our review consisted primarily of inquiries, observations, and selected tests of internal control policies and procedures, accounting records, and related documents. The review was more limited than would be necessary to give an opinion on internal controls. Accordingly, we do not express an opinion on internal controls or ensure that all deficiencies in internal controls are disclosed.

Specifically, we reviewed cash receipts, cash disbursements, transfers and journal entries, payroll, purchasing, checking accounts, and equipment.

As a result of our review, we noted certain deficiencies in internal controls over purchasing, travel, and cash disbursements that the Commission's management should correct to ensure that it fulfills its responsibility to establish and maintain adequate control. We must emphasize that the seriousness of the deficiencies cited indicates that the Commission inefficiently or inappropriately used over $1 million of public monies. Our findings and related recommendations are described in the accompanying summary. The *State of Arizona Accounting Manual* also contains guidance that will help the Commission correct these deficiencies.

This letter is intended solely for the information and use of the Commission and is not intended to be and should not be used by anyone other than the specified party. However, this letter is a matter of public record, and its distribution is not limited.

Should you have any questions concerning our procedural review, please let us know.

Sincerely,

Dennis L. Mattheisen, CPA
Financial Audit Director

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INTRODUCTION & SUMMARY

The Commission for the Deaf and the Hard of Hearing (formerly the Arizona Council for the Hearing Impaired) provides services to Arizona's deaf and hard-of-hearing community to improve their quality of life. These services include information and referral, education, text telephone (TTY) distribution and repair, and telecommunications and relay services. A 14-member commission is charged with setting policy and employs an executive director, deputy director, and 9-person staff to help carry out the Agency's mission.

In fiscal year 1999, the Agency's operating costs were funded by appropriations of approximately $262,000. In addition, the Agency administers the Telecommunications Device for the Deaf Fund (TDD Fund) which was only used to operate a statewide telephone dual-party system and support the Agency TTY distribution program. The TDD Fund is funded by the Telecommunications Excise Tax (TE Tax) that is levied as a surcharge on each wire service account and deposited into the TDD Fund. The TDD Fund had accumulated a surplus of approximately $3 million at June 30, 1999, as TDD Fund revenues had exceeded expenditures over the last several years. Beginning in fiscal year 2000, the Legislature authorized the Agency to use the TDD Fund monies to pay for its operating costs and increased the operating budget by almost $1.2 million, or 458 percent. The fiscal year 2001 operating budget remained essentially the same.

In fiscal year 2001, the Agency received revenues of $6.2 million to provide services. Approximately $6.1 million was received from the TE Tax. The remainder consisted of federal grant monies and interest on investment.

The Agency did not have a plan to effectively manage this significant increase in its operating budget. Specifically, the Agency

- Contracted for services and goods without adequate planning,
- Made inappropriate payments to vendors,
- Disregarded guidelines designed to spend public monies efficiently, and
- Purchased items that constituted gifts of public monies.

The policies and procedures outlined in the Arizona Revised Statutes, the State of Arizona Accounting Manual, and the Arizona Procurement Rules and Regulations help to ensure that public money is used prudently. However, the Agency failed to follow the established rules for purchasing and paying for over $1 million in goods and services, including nearly $803,000 in payments to a single vendor.

FINDING 1

The Agency awarded nearly $803,000 in ten contracts to one vendor without adequate planning

The State's Procurement Code exists to help ensure that agencies obtain the best value for the public money they spend. The Code also exists to allow private companies to compete fairly for the State's business. For example, agencies must purchase from vendors already screened by the State Procurement Office (SPO) or have SPO issue a request for competitive proposals (RFP). In the interest of efficiency, SPO may allow an agency to purchase goods or services up to a specified dollar limit without contracting through SPO. The delegated spending limit for the Commission for the Deaf and the Hard of Hearing was $5,000.

The Agency failed to adequately determine its needs, identify vendors that might reasonably respond to a request for proposal, and determine the time needed to complete projects. Consequently, qualified vendors may have been precluded from submitting proposals. The Agency also compressed procurement process time frames, which may have precluded an adequate number of vendors from submitting proposals.

Auditors noted the following problems with the Agency's contracts with one vendor (Vendor).

- Contracts 1-5—The Agency entered into five agreements for consulting services with an individual over a 7-month period, from August 2000 through February 2001. The entire fee for this work was $18,000, an amount that exceeded the Agency's delegated spending authority by $13,000. The executive director should have requested that SPO contract for these services. Instead, the executive director and the Vendor's president entered into a series of five consecutive consulting contracts, keeping each contract under the Agency's delegated spending authority. By dividing the contract into smaller ones, the executive director circumvented the need to follow the Arizona Procurement Rules and Regulations requirements for written quotations.

Lack of adherence to procedures and inadequate planning resulted in the Agency awarding nearly $803,000 in ten contracts to the Vendor and the Vendor's president.

- Contract 6—$121,300 for creating public service announcements for television. Originally awarded to the Vendor for $64,000 in September 2000, the Agency amended the contract in December 2000 because it had not anticipated that the contract needed technical assistance. The Agency had assumed that the local television station would continue to provide technical assistance free of charge. When the Agency discovered that free technical assistance was no longer available, it should have requested bids for that element. At the same time, the Agency decided to double the time for each announcement. Consequently, it added $57,300 to the existing contract for technical assistance and increased time for each announcement.

- Contract 7—$305,202 for equipment distribution. Initially, SPO issued an RFP. However, no responses were received because the vendor list that the executive director gave SPO contained vendors that could not reasonably be expected to distribute TTY machines. When the RFP deadline had passed, the Vendor submitted a proposal. After negotiations with SPO, the Vendor was awarded the contract. At a minimum, a request for proposal should have been sent to other known vendors or researched vendors with other state agencies using similar services. Nonetheless without competing proposals, the executive director recommended that the Vendor be awarded the contract.

- Contract 8—$100,520 for consulting services. A nationally known not-for-profit vendor submitted a low proposal for $51,840. However, the RFP had failed to disclose that not-for-profit vendors were ineligible. Subsequently, the selection committee consisting of three people, two of whom were agency employees, awarded a contract for $89,440 to the Vendor. At a minimum, the Agency should have adequately developed an RFP including researching other state agencies using similar services. Later, the contract was extended for 45 days, and the Vendor was paid an additional $11,080.

  $1,400 for additional consulting services. During the contract period, the executive director hired one of the Vendor's employees to provide additional interpreter and training services that were included already under the provisions of Contract 8. As a result, the Agency paid an additional $1,400 for services already included in Contract 8.

- Contract 9—$256,550 to develop and produce open-captioned videotapes. At the Agency's request, SPO advertised the request for proposals on May 21, 2001, and wanted the project completed by June 30, 2001. The Vendor was the only vendor that submitted a proposal and was awarded the contract on June 12, 2001. At June 29, 2001, the Vendor delivered videotapes that failed to meet the contract's specifications. The Vendor did not complete the project until 11 months later.

- Contract 10—to prepare and host a television program, “Sign Out.” The Agency sent the request for proposals to companies that could not reasonably be expected to meet the specific requirements to prepare and host the “Sign Out” program. The Vendor was the only vendor that submitted a proposal, and therefore, it was awarded the contract. At a minimum, the Agency should have researched potential vendors prior to issuing the RFP. The contract amount was $1,018 per taping session, and the Vendor could earn approximately $14,000 per year over a 5-year period. Under Contract 10, the Vendor is allowed to select the interpreter to be used. Further, the Agency is to pay for these services separately. However, the Vendor is an approved vendor for interpreter services. As a result, under Contract 10, the Vendor could hire itself and be paid an additional fee to provide interpreter services.

The Vendor was unable to complete two of the ten contracts as agreed. Specifically, the Vendor was behind schedule for Contract 6. Further, as of May 10, 2002, the Vendor had missed Contract 9’s completion date by more than 10 months.

FINDING 2

The Agency made inappropriate payments to vendors

Prudent business practice requires that an agency pays vendors only after verifying that services have been performed or goods have been received. However, the Agency failed to follow those procedures and made the following inappropriate payments to the contracts mentioned in Finding 1:

- Contracts 3 and 4—paid $7,500 to the Vendor's president. The Agency paid two invoices from the Vendor's president without adequate supporting documentation. The invoices lacked a description of the professional services performed. Consequently, the Agency could not verify that services were received.

- Contract 6—paid $30,325. The Agency paid the Vendor three monthly installments and the remaining balance upon completion of the contract. However, the contract specified payment only upon completion. Consequently, the monthly installments constituted unauthorized payments in advance of the receipt of goods.

- Contract 9—paid $256,550. The Agency paid the Vendor in full for this contract before June 30, 2001. However, as of that date, the Vendor failed to produce any videotapes that met the needs of the Agency. Over half of the videotapes were not received until almost a year after they had been paid for.

Payments were made before the services were performed.

FINDING 3

The Agency disregarded prudent business guidelines for spending public monies

Taxpayer dollars support state agency operations and agency officials have a duty to use those monies prudently. The Agency spent $127,864 without following the appropriate guidelines, failing to use taxpayer dollars prudently.

Public monies were not spent prudently.

- The Agency paid $93,163 to develop equipment-tracking software. The software was intended to help control its inventory of TTY machines and help track client information. However, the executive director failed to obtain the Government Information Technology Agency's (GITA) permission before making the purchase even though all agencies are required to obtain GITA approval before spending over $25,000 for computer equipment or software. In fact, had the executive director sought GITA's approval, she would have discovered that adequate equipment-tracking software was available off-the-shelf for approximately $5,000.

- The Agency inappropriately spent $15,938 for the use of commercial locations, catered food, and hotel rooms in excess of reimbursement rates for 14 meetings, training sessions, and staff retreats as shown in Table 1.

  The Agency used hotel conference rooms for meetings, trainings, and staff retreats at a cost of $7,175. These sessions should be held at state-owned locations to minimize costs.

  Also, the Agency paid $6,405 for catered food for meetings in Phoenix that employees and the public attended. An additional $1,882 was spent for catered food at out-of-town meetings that employees on travel status and the public attended. However, the Agency could not demonstrate that it had stayed within the state reimbursement rate for employees' meals on travel status. The following three situations are examples of providing gifts of public monies: providing meals to employees on travel status in excess of reimbursement rates, to employees in Phoenix, and to the public.

In addition, the Agency paid $476 more than the maximum lodging amount allowed under state travel reimbursement guidelines. The Agency also paid for employees' lodging for a staff retreat in Sedona and a Council meeting in Tucson instead of requiring employees to seek travel reimbursement.

Table 1: Cost of Events
July 2000 through February 2002

Description	Amount
Hotel conference rooms	$ 7,175
Catered food	8,287
Excess hotel lodging costs	476
Total	$15,938

Source: Auditor General staff analysis of financial data and supporting documentation provided by the Commission for the Deaf and the Hard of Hearing.

Finally, the Agency incorrectly classified these expenditures as conference registration and miscellaneous operating expenditures instead of as miscellaneous rent, food, and lodging.

- The Agency paid $18,763 to sponsor a booth at a conference for professional sign language interpreters in Florida. The Agency exceeded their $5,000 delegated spending authority and contributed more than any other governmental sponsor. In the Agency's response to an Office of the Auditor General performance audit report of the Agency (AG Report 99-14, page iii), the Agency stated that staff attended the conference to recruit students to become professional interpreters. However, the focus of the conference was to conduct the business of the Registry of Interpreters for the Deaf and provide professional development seminars and workshops. Consequently, the most appropriate venue to recruit potential interpreters was not chosen. Further, the Agency could not demonstrate the effectiveness of this conference in recruiting professional interpreters. Table 2 describes the conference costs.

Table 2: Conference Costs
August 2001

Description	Amount
Rental of booth props	$ 5,796
Booth space and conference registration	5,500
Graphics and furnishings	3,184
Tax	671
Shipping	648
Miscellaneous	588
Material handling	576
Exhibitor services–floral	518
Exhibitor services–electrical	444
Flooring	384
Banquet tickets	175
Exhibitor services–cleaning	154
Storage and delivery	125
Total	$18,763

Source: Auditor General staff analysis of financial data and supporting documentation provided by the Commission for the Deaf and the Hard of Hearing.

FINDING 4

The Agency purchased items that constitute gifts of public monies

Despite a statutory prohibition against gifts of public monies, the executive director spent $168,118 without demonstrating that the expenditures served a public purpose.

The Agency had specific authority to promote the telecommunications relay service; however, that authority was limited to placing advertisements in telephone directories. Nonetheless, the executive director approved the purchase and distribution of the promotional items to the public. Table 3 describes the promotional items.

The Agency spent $168,118 for promotional items that were considered gifts of public monies.

Table 3: Cost of Promotional Items
May 2000 through June 2001

Description	Amount
Sunshades	$ 27,735
Magnets	16,595
Prepaid phone cards	15,894
Miscellaneous	15,355
Pens	10,148
Leather coasters	9,836
Lunch and plastic bags	9,008
Chip clips and screwdriver tool kits	8,783
Pill boxes	8,147
Mouse pads	8,036
Stress balls	7,847
Stickers, note pads, and holders	7,417
Business cards, magnifiers, direct mailers	6,935
Key tags	6,736
Jar and letter openers	5,846
Cowboy hats	3,800
Total	$168,118

Source: Auditor General staff analysis of financial data and supporting documentation provided by the Commission for the Deaf and the Hard of Hearing.

The executive director purchased these items from a vendor under state contract for employee recognition awards. However, the executive director used these items as advertising rather than for employee recognition. Further, the Agency failed to classify these expenditures as promotional items in its accounting records. Doing so would have required specific budget authority. Instead, the Agency classified the expenditures as miscellaneous operating and office supplies.

Recommendations

The Commission for the Deaf and the Hard of Hearing has been entrusted with spending public monies to provide vital services to Arizona's deaf and hard-of-hearing community. That trust bears a responsibility to spend public monies appropriately and to obtain the best value for the money spent. The following recommendations should be implemented.

The Agency should adequately plan for purchasing services and goods—This would include the executive director adhering to the delegated spending limit. In order to avoid the appearance of circumventing spending limits purchases may not be artificially divided into smaller purchases to avoid involving SPO in the purchase. If services are needed more than once, the Agency should consult SPO before additional services are purchased. SPO should be involved in purchases that exceed the Agency's delegated spending limit of $5,000 to help ensure that the Agency obtains the most advantageous vendor and price. The spending limit was put in place to ensure that the Agency's purchases are the most reasonable use of state monies by requiring a certain level of review.

The Agency should plan adequately for any major projects. Before issuing a request for proposal, the Agency should undertake the research necessary to determine all of the factors related to the project. For example, the Agency should determine its needs and then ask other state agencies with similar programs for contract and vendor suggestions. If necessary, the Agency should hire an outside vendor or contact SPO for research, vendor search, and contract writing assistance. Doing so would open the process to multiple qualified vendors, enhance competition, help ensure that the best price is obtained, and eliminate the need for contract amendments. In addition, the Agency should

- Ensure that contracted vendors who respond to a new request for proposal are able to fulfill the requirements of current contracts as well as deliver new services and goods.
- Use contracted services instead of paying vendor employees individually for those services.
- Give vendors adequate time to respond to requests for proposals.
- Ensure that the contracts do not allow the contracted vendor to influence the terms of subsequent contracts or the selection of subsequent vendors. This would prevent the vendor from hiring itself for additional services.

The Agency should pay vendors only after it receives contracted goods and services—Adhering to appropriate disbursement controls helps ensure that the Agency receives goods and services meeting the contractual requirements, pays the contracted price, and does not make a payment until it is due under the contract's terms. For example, agency staff should properly document receipt of goods and services, and the vendor invoice should properly describe the goods and services or cite the appropriate contract. A designated agency supervisor should examine the documentation supporting a proposed disbursement, authorize the disbursement, and document that authorization. Prior to making a payment, the Agency should ensure goods and services meet the contract requirements. Further, the Agency should retain all supporting documentation. (Arizona Revised Statutes [A.R.S.] §35-342; *State of Arizona Accounting Manual* [AAM], section II-H-1, pages 5 and 9; *Uniform Instructions to Offerors*, section 5.F; *Uniform Terms and Conditions*, section 4.A.; and language specific to Contract 4, see page 3)

The Agency should follow prudent business guidelines for spending public monies—Agency personnel should be mindful of their fiduciary duty to spend public monies in an appropriate manner. For example, when contemplating future computer equipment and software purchases, staff meetings, training sessions, retreats, and conference attendance, the Agency should adhere to the following guidelines:

- Seek approval from GITA for computer equipment and software purchases over $25,000. Through this process, GITA will assist the Agency in determining the most efficient and cost-effective equipment or software for its needs. (A.R.S. §§41-2513, 41-3504, and Statewide Policy P340)
- Refrain from using public monies to provide food at meetings and training sessions. If refreshments are desired, employees should provide their own. Further, the Agency should pay no more than the maximum lodging amount allowed under state travel reimbursement guidelines. Requiring employees on travel status to submit travel claims for reimbursement of food and lodging would help ensure that food and lodging expenditure limits are followed. The Agency should also use state facilities where possible for meetings and training sessions and properly classify its expenditures in the accounting records. (AAM, section II-D-2, page 3; AAM, section II-H-1, pages 6 and 7; and AAM, section IV-C, pages 5, 6, 14, 17, and 18)
- Evaluate conferences to determine whether attending a specific conference will meet agency goals. In addition, the Executive Director should evaluate and document the attendance and exhibition costs in relation to the expected benefit and observe the delegated spending limit. (AAM, section II-H-1, page 3)

The Agency must ensure that public monies are not used to buy gifts—The Arizona Constitution prohibits giving gifts or loans to individuals. The notes to this provision of the Constitution also advise that public monies must be spent only for public purposes. Therefore, the Agency may not purchase promotional items unless granted specific authority to do so. (Arizona Constitution, Article 9, section 7, note 5; *Arizona Procurement Rules and Regulations* R2-7-311.A)

Janet Napolitano
GOVERNOR

Arizona Commission for the deaf and the hard of hearing

Sherri L. Collins
EXECUTIVE DIRECTOR

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February 10, 2003

Mr. Dennis L. Mattheisen, CPA
Financial Audit Director
2910 North 44th Street, Suite 410
Phoenix, AZ 85018

Dear Mr. Mattheisen,

I am writing in response to the Financial Audit Procedural Review Report of the Arizona Commission for the Deaf and the Hard of Hearing as of May 10, 2002. I have reviewed the four major recommendations in the Audit Report and intend to respond to them in this letter.

The procedural review of the Arizona Commission for the Deaf and the Hard of Hearing (ACDHH) began in July, 2000 and closed on May 10, 2002. According to your letter, your office conducted inquiries, observations and reviews of financial policies and procedures of ACDHH financial transactions. I will respond to the audit report recommendations.

The four major recommendations from the Audit Report are written bold font.

Recommendation 1: **The Agency should adequately plan for purchasing services and goods.**

The executive director should plan purchases to adhere to the delegated spending limit.

Agreed. Due to agency staff changes inappropriate information was given to the executive director. It was not until after the fact the mistake was discovered. The executive director is aware of the delegated spending limit policy.

The agency should plan adequately for any major projects-Before issuing a request for proposal, the Agency should undertake the research necessary to determine all of the factors related to the project.

- ***Ensure that contracted vendors who respond to a new request for proposal are able to fulfill the requirements of current contracts as well as deliver new services and goods.***

Agreed regarding Contract 1-5.

Agreed regarding Contract 6. The agency lacks expertise in drafting the scope of work for contract for the production of public service announcement videotapes. ACDHH shall hire a qualified outside consultant to address this issue when/if such future contacts for videotape production occur.

Disagreed regarding Contract 7. In preparation for soliciting a Request for Proposal (RFP) for Telecommunications Equipment Distribution Program (TEDP), the former Telecommunications Relay Service (TRS) Administrator researched other states that provide TEDPs. The TRS administrator used the information gathered to write the scope of work of the RFP. In addition, the agency provided State Procurement Office (SPO) with a list of 15 vendors. Due to no response the ACDHH board recommended the executive director work with SPO to request "impractical to compete" consideration. The board further directed that ACDHH ask for approval from SPO to contract with Hands On Communication as a temporary solution until the agency was ready to launch the new voucher program. The new voucher program became effective on November 18, 2002. The contract with Hands on Communication has expired on October 31, 2002.

Agreed regarding Contract 8. The agency could have been more specific in the scope of work for the consulting contract. Only two vendors submitted proposals for RFP No. AD-010195. Hands On Communications was the only vendor that met the general and specific requirements in the scope of work, and therefore was awarded the contract.

- **Use the contracted services instead of paying vendor employees individually for those services.**

  Agreed.

- **Give vendors adequate time to respond to requests for proposals.**

  Agreed.

- **Ensure that the contracts do not allow the contracted vendor to influence the terms of subsequent contracts or the selection of subsequent vendors. This would prevent the vendor from hiring itself for additional services.**

  Agreed regarding Contract 9.

  Agreed regarding Contract 10. The agency uses Hands on Communication to host a television program, "Sign Out", on an as needed basis. From January 29, 2002 - December 31, 2002 the total expenditure was $9,342.00.

  Hands on Communication was removed from the statewide sign language service contract.

Recommendation 2: **The Agency should pay vendors only after it receives contracted goods and services-Adhering to appropriate disbursement controls helps ensure that the Agency receives contracted goods and services, pays the contracted price, and does not make a payment until its due under the contract's terms.**

Arizona Commission for the deaf and the hard of hearing

Agreed regarding Contract 3,4,6 and 9.

Recommendation 3: **The Agency should follow prudent business guidelines for spending public monies-Agency personnel should be mindful of their fiduciary duty to spend public monies in an appropriate manner.**

Seek approval from Gita for computer equipment and software purchases over $25,000.

Agreed. The agency learned before receiving the audit report that getting an approval from GITA was required before purchasing the software.

Refrain from using public monies to provide food at meetings and training sessions.

Agreed. Due to the circumstances with staff turnover during the audit review the executive director assumed proper documentations were handled. The agency sometimes will use hotels for meetings to meet disability accommodation requirements. It is difficult to find and schedule state-owned meeting locations that provide the accommodation requirements necessary for people who are deaf, hard of hearing and deafblind.

Evaluate conferences to determine whether attending a specific conference will meet Agency goals. In addition, the Executive Director should evaluate the attendance and exhibition costs in relations to the expected benefit.

Disagreed. The agency believes attendance to specific conferences meet the agency goals.

Recommendation 4: **The Agency must ensure that public monies are not used to buy gifts.**

Agreed. The agency's intent was to use the promotional materials for the Arizona Relay Service as indicated in AD980121-001 amendment contract, as well as to use the materials for agency public relations events. The agency assumed the documentation was properly filed. This has been corrected in agency's file. In the current Arizona Relay Service contract no. ADO 10240-001 with MCI includes the requirement for MCI to provide outreach activities as well as promotional materials.

We appreciate the work of the audit staff and their recommendations. In summary, the intent of ACDHH has always been to comply fully with state policies and procedures. The agency has been proactive in correcting procedural errors as soon as they are identified. The recommendations made by the audit staff have been initiated. As always we are ready to respond to any questions or comments from the Office of the Auditor General.

Sincerely,

Sherri L. Collins
Executive Director