



A REPORT  
TO THE  
ARIZONA LEGISLATURE

Financial Audit Division

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Management Letter

# Department of Economic Security

Year Ended June 30, 2003

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**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

June 30, 2004

David A. Berns, Director  
Department of Economic Security  
1717 West Jefferson Street  
Phoenix, AZ 85007

Dear Mr. Berns:

In planning and conducting our single audit of the State of Arizona for the year ended June 30, 2003, we performed the following as required by *Government Auditing Standards* (GAS) and Office of Management and Budget (OMB) Circular A-133:

- Considered the Department's internal controls over financial reporting,
- Tested its internal controls over major federal programs, and
- Tested its compliance with laws and regulations that could have a direct and material effect on the State's financial statements and major federal programs.

Specifically, we performed tests of revenues, receivables, expenditures, payables, transfers, cost allocation, payroll, purchasing, bank accounts, capital assets, financial reporting, and the Food Stamps Cluster, Trade Adjustment Assistance—Workers, Workforce Investment Act Cluster, Temporary Assistance for Needy Families, and Social Security—Disability Insurance programs.

All audit findings that are required to be reported by GAS and OMB Circular A-133 have been included in the State of Arizona's Single Audit Reporting Package for the year ended June 30, 2003, and have been communicated to your staff. In addition, our audit disclosed internal control weaknesses and instances of noncompliance with laws and regulations that do not meet the reporting criteria. Management should correct these deficiencies to ensure that it fulfills its responsibility to establish and maintain adequate internal controls and comply with laws and regulations. Our recommendations are described in the accompanying summary.

This letter is intended solely for the information of the Department 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 its contents, please let us know.

Sincerely,

Dennis L. Mattheisen, CPA  
Financial Audit Director

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## The Department should protect its information system from damage and equipment failure

The Department uses a computerized information system to process its financial transactions. Therefore, it is vital that the Department have an up-to-date contingency plan so it will be able to process all pertinent transactions should a major computer hardware or software failure occur. However, the Department did not have a current and tested disaster recovery plan or have an agreement with an alternative computer facility that can be used to process daily transactions. Also, transactions were backed up daily, however, backup tapes were transferred only weekly to an off-site facility. Therefore, all data for the current week could be lost during a disruption or disaster.

To help ensure the Department's computer system is protected against system or equipment failure and to help prevent loss of data from a service interruption, the Department should update and test its disaster recovery plan annually. In addition, the Department should ensure the plan includes the following:

- A listing of employees assigned to disaster teams, including telephone numbers.
- Employee assignments and responsibilities.
- A risk analysis identifying critical transaction cycles.
- A designated alternative computer facility.
- Details of off-site storage locations.
- A list of procedures for processing critical transactions, including forms or other documents to use.

Because the Department's computer system is unique, one contingency plan may be for the Department to maintain a replacement system at an alternative site. At a minimum, the Department should maintain an alternative site with other state agencies to reduce overall expenses. Further, the Department should back up transactions and store the information in an off-site facility daily.

A similar recommendation was previously provided in our Management Letter to the Department dated June 12, 2003.

## The Division of Developmental Disabilities should properly account for its financial activity

The Division of Developmental Disabilities' mission is to support individuals with disabilities and their families by promoting and providing, within communities, flexible, quality, consumer-driven services and support. These individuals are the Division's recipients of Title XIX federal assistance and, therefore, the Division must account for these services accurately. In order to achieve its mission, the Division's Tucson Office contracted with the U.S. Air Force and local companies to provide job opportunities for its recipients. Specifically, the Division charged fees to the contracted parties for paper-recycling services provided by its recipients. Then, the Division paid wages from the fees collected to its recipients who provided the services. However, the Division did not record approximately \$50,000 in revenues collected and wages paid during fiscal year 2003 in the Financial Management Control System (FMCS), the Department's accounting system. Rather, the Division recorded this financial activity in its checking account. As a result, payroll withholdings, such as income tax, Social Security, and Medicare, were not deducted from the recipients' wages, and the wages were not reported to the Internal Revenue Service or the Arizona Department of Revenue as required by United States Code, Title 26, Internal Revenue Code and Arizona Revised Statutes §43.401.

To comply with United States Code, Title 26, Internal Revenue Code and Arizona Revised Statutes §43-401, the Division should report its recipients' wages and withholdings to the proper state and federal agencies. In addition, the Division needs to record all financial activity on the FMCS to ensure all Department revenues and expenditures are included in its financial statements.

## The Division of Child Support Enforcement should accurately account for child support

The Division of Child Support Enforcement should maintain accurate child support records to ensure that proper amounts are collected from noncustodial persons and paid to custodial persons, and that delinquent child support balances are properly reported to the U.S. Department Health and Human Services (USDHHS). However, the Division did not maintain accurate child support records because monthly obligations and court-ordered judgments were not always entered into the accounting system accurately. For four of five significant delinquent receivables tested, the Division inaccurately entered the obligated amount and, therefore, overstated the receivable. For example, one obligated amount was entered at \$12,720 per month instead of \$127.20. As a result, the Division reported over \$1.4

million in overdue child support payments that was not owed. Another child support receivable balance was recorded at over \$2 million when the noncustodial person owed only \$20,348. Consequently, the Division did not report the correct receivable balances to USDHHS. However, these receivable balances did not affect federal funding since they represent amounts owed to custodial persons by noncustodial persons.

To help ensure that child support amounts are accurately recorded and collected from noncustodial persons, the Division should establish a procedure to ensure that amounts entered in the accounting system agree to the judgments. In addition, the Division should periodically review and investigate unusually high receivable balances. This would also help ensure that accurate child support receivable amounts are reported to USDHHS.

## The Division of Benefits and Medical Eligibility should comply with federal eligibility requirements

The Division of Benefits and Medical Eligibility, Family Assistance Administration (FAA) administers the Food Stamps federal program and is responsible for determining eligibility based on such factors as the recipient's household size and financial resources. In accordance with the Code of Federal Regulations (CFR), the FAA offices are required to maintain documents to support eligibility determinations. However, for 8 of 32 recipients tested, the FAA offices did not comply with the federal regulations and maintain complete and accurate records. For example, some applications were incomplete, more than one social security number was used by the same recipient, and a file could not be located. Also, recipients continued to receive benefits even though they could not be located or would not provide additional information to the Quality Control Unit. Further, the Office of Accounts Receivable was not informed of food stamp overpayments in a timely manner so it could pursue collection. As a result, auditors noted the Division overpaid these recipients \$5,682 in food stamp benefits.

To comply with 7 CFR §273.2, the Division should:

- Assign a second employee to review all forms and applications for completeness, accuracy, and consistency.
- Retain all forms and applications in recipient files that are filed alphabetically.
- Discontinue benefits when recipients can not be located or refuse to provide required information.
- Immediately inform the Office of Accounts Receivable of overpayments.

## The Unemployment Insurance appeals process needs to be more timely

The Division of Employment and Rehabilitation Services, Employment Administration is responsible for administering the Unemployment Insurance program that includes an opportunity for employers to appeal the initial eligibility determination. During the appeals process, a recipient continues to receive unemployment insurance benefits. For 1 of 42 unemployment insurance cases tested, the Administration did not comply with the U.S. Department of Labor guidelines to ensure that the appeal was decided within 90 days after the appeal was filed. As a result, an ineligible recipient was overpaid \$8,404 in benefits.

To comply with the U.S. Department of Labor guidelines and help minimize overpayments, the Employment Administration should rule on appeals within 90 days after the appeals are filed.

## The Division of Employment and Rehabilitation Services needs to comply with federal cash management requirements

The Division of Employment and Rehabilitation Services receives advance federal funding to administer the Trade Adjustment Assistance—Workers program; however, it still must spend this money 3 days after it receives the advances as required by federal cash management requirements. The Division did not comply with these requirements since sometimes it took the Division as long as 30 days to spend the advances. The Division did not earn interest income during the audit period and, therefore, there was no questioned cost. However, if the monies were maintained in an interest bearing account, the Department would have likely earned over \$100. Earned interest over \$100 should be remitted to the federal government.

To comply with 29 CFR §97.20(b)(7), the Division must spend federal monies 3 business days after monies are received from the U.S. Treasury.



ARIZONA DEPARTMENT OF ECONOMIC SECURITY

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Janet Napolitano  
Governor

David A. Berns  
Director

JUN 15 2004

Debra K. Davenport  
Auditor General  
Office of the Auditor General  
2910 North 44th Street, Suite 410  
Phoenix, Arizona 85018

Dear Ms. Davenport:

Thank you for the opportunity to respond to the management letter for the financial statement audit of the Department and the single audit of the State of Arizona for the fiscal year 2002-03.

It is understood that this response will be included in the published management letter.

The Department wishes to express its appreciation to you and your staff for the time and effort invested in these audits.

Sincerely,

David A. Berns

Enclosure

**DEPARTMENT OF ECONOMIC SECURITY  
RESPONSE TO THE FISCAL YEAR 2002-03  
MANAGEMENT LETTER**

**The Department should protect its information system from damage and equipment failure**

During the last fiscal year, the Department produced a Disaster Recovery Plan (DRP) outline and has "filled in" many of the sections. Specifically, all applications systems' back-up requirements were analyzed and documented. The Department has a full-time Disaster Recovery Coordinator position and is continuing to complete sections of the DRP.

The Department back-up tape storage site was recently moved from a state facility located just two blocks from the Data Center to a facility owned by a commercial back-up tape storage firm that is a safe distance from the Data Center. Both mainframe and server farm back-up tape transportation and storage are now handled by that firm.

The Department collaborated with the Arizona Department of Administration (ADOA) and Department of Public Safety (DPS) to develop a tri-agency mutual back-up plan and related Project Investment Justification. Phase I of the plan is for all three agencies to contract with a vendor for hot site back-up services.

The Information Technology Authorization Committee approved Phase I of the tri-agency plan and the legislature appropriated funding for back-up services in the Department's fiscal year 2005 budget. The Department also participated in the production and evaluation of a Request for Proposals for hot site back-up services. The Division of Technology Services will contract for such services in the first quarter of fiscal year 2005 and will test the DRP tape restoration process during the next 12 months.

While the Department is very pleased to be able to contract for hot site back-up services, restoring over 1,300 weekly back-up tapes is a tedious and error prone process. To avoid this time-consuming process and potential data loss, Phase II of the tri-agency DRIP includes mutual data mirroring at the participating data centers (ADOA and DPS). The advantages of mirroring are minimal downtime and simple data recovery. The Department will continue to work with ADOA, DPS, and the Government Information Technology Agency to seek funding to implement Phase II of the DRP.

**The Division of Developmental Disabilities should properly account for its financial activity**

Division of Developmental Disabilities, District II Business Operations entered into contract negotiations with the Davis Monthan Air Force Base (DMAFB) in 1998 to provide recycling services by Division day program clients. The terms of the contract negotiated in 1998 provided for wage compensation for clients, as well as

**DEPARTMENT OF ECONOMIC SECURITY  
RESPONSE TO THE FISCAL YEAR 2002-03  
MANAGEMENT LETTER**

all covered expenses to operate the recycling program. A contract to bring the Division's day program clients onto the state payroll system as seasonal employees was signed into agreement in 2000 under the direction of the State Attorney General and the Department. Without a vehicle to provide for additional health and welfare benefit compensation mandated by the federal contract or a means to conduct wage adjustments following bi-annual productivity and other federal contract requirements, the Department was unable to comply with the requirements of the federal contract without going through an individual bank account at the local level. The variance between the state wages and the federal wages was paid out of the local account because there was no means to deduct withholdings until 2004.

District II Business Operations has worked with Division management and Division of Business and Finance, Financial Services Administration staff to determine a means to bring the DMAFB contracted employees into state and federal compliance. The Department will convert these funded work program services to the Department's payroll system and record the transactions on FMCS by establishing these day program clients as state seasonal employees. The Department is currently in the process of creating these uncovered, funded, seasonal positions. This will result in all financial activity being recorded on FMCS and bring the Division into compliance with all state and federal withholding requirements.

**The Division of Child Support Enforcement should accurately account for child support**

The Division of Child Support enforcement is utilizing multiple approaches to help ensure that accurate child support records are maintained and that balances are properly reported to the U.S. Department of Health and Human Services. In addition to the established procedures, a Computer Based Training course has been developed to provide ongoing review training to staff in their local offices. This issue will also be an ongoing topic in the monthly Continuing Debt Education Training provided to staff. Additionally, a special project has been formed to review and verify all cases with a high delinquent child support balance, and a monthly report has been created to identify high child support balances for immediate review and verification.

**The Division of Benefits and Medical Eligibility should comply with federal eligibility requirements**

To comply with 7 CFR §273.2, Division of Benefits and Medical Eligibility has implemented the following procedures:

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RESPONSE TO THE FISCAL YEAR 2002-03  
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To help ensure the completeness, accuracy and consistency of all forms and applications, on March 9, 2004, a reminder was issued to all Division field staff that all numbered questions on the Interview Guide (FAA-001-B) must be asked during the interview, and all supervisors must review the reminder with their staff within 30 days from the date of issuance. In addition, the Department has initiated a workgroup to develop an automated interviewing guide. The automated interviewing guide will require the eligibility interviewer (EI) to key a response into the system to all questions asked during the interview process. Each question must be asked and a response keyed before the EI can proceed to the next question.

To help ensure that all forms and applications are retained in recipient files that are filed alphabetically, Division regional program managers are reviewing file maintenance procedures at the local offices. Regional program managers have made file room reorganization a priority in all local offices. Furthermore, the Division is moving forward with plans to obtain a Document Management System.

To help ensure that benefits are discontinued when recipients can not be located or refuse to provide required information, the Department will take immediate action to request verification of the change. The participant will have ten days to respond to the letter requesting verification of the change. If the participant fails to respond in ten days, the case will be closed. Formerly, federal policy did not allow the Division to act on changes unless and until the participant reported and verified the change directly to the Department.

To help ensure that the Office of Accounts Receivable is immediately informed of overpayments, on January 20, 2004, the Division implemented the first phase of an automated overpayment tracking system. In Phase I, overpayment referrals are tracked from date of discovery through the overpayment claim date as provide for in the program federal guidelines. On May 1, 2004, the Division implemented Phase II, which included a system design to enhance data integrity and capture additional data elements for use in monitoring internal performance measures. On June 1, 2004, the Division began implementing Phase III, which began system production of the statewide Overpayment Summary Report. Additional overpayment reports are currently being programmed and tested, which will be used to monitor performance measures. The Division anticipates the balance of these overpayment reports to progressively become system production reports no later than September 2004.

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RESPONSE TO THE FISCAL YEAR 2002-03  
MANAGEMENT LETTER**

**The Unemployment Insurance appeals process needs to be more timely**

The Division of Employee Services and Support, Appellate Services Administration (ASA) is responsible for the timely processing of appeals. The national criteria established by the Secretary of Labor for the timely disposition of first level unemployment insurance appeals is 60% within 30 days and 80% within 45 days.

During 2002, ASA was not able to meet the U.S Department of Labor (USDOL) standards due to the huge influx of appeals resulting from the economic downturn; consequently, USDOL imposed a corrective action plan on ASA. First level appeals are now in compliance with the USDOL standards. ASA met or exceeded the 30-day standard in all but one of the last 12 months. ASA met or exceeded the 45-day standard in all of the last 12 months. All but a very small percentage of cases are disposed of within 75 days; for example, in April 2004, 97.28% of cases were disposed of within 75 days. Therefore, the timeliness problem that existed has been eliminated, and the appeals process is no longer causing the creation of large overpayments.

ASA is committed to maintaining its current level of timeliness and is employing the following strategies to help ensure continued timeliness:

1. ASA is transitioning to a process of receiving appeal documentation electronically. This process will reduce delay in the appeal transmission process.
2. ASA is beginning to use paralegals in the appeal screening and scheduling processes. This is allowing greater coordination between the appeals offices in maximizing timeliness.
3. ASA is embarking upon the development of a new case tracking and appeals management system that will improve speed, accuracy and efficiency. Included in the new system will be an automated scheduling process that will maximize timeliness by ensuring that cases are scheduled for the earliest possible date. Also included in the system will be management reports that will allow the early detection and diagnosis of timeliness problems.
4. ASA monitors weekly its performance on timeliness as well as the number of pending cases in various case aging categories so that there is an early warning of developing timeliness problems and to minimize the possibility of lost cases. When monitoring discloses that productivity demands will likely not be met, temporary employees are utilized to meet the demand.

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RESPONSE TO THE FISCAL YEAR 2002-03  
MANAGEMENT LETTER**

**The Division of Employment and Rehabilitation Services needs to comply with federal cash management requirements**

To comply with federal cash management requirements, the Division of Employment and Rehabilitation Services will develop procedures to minimize the time elapsing between the drawdown and disbursement of federal funds for the Trade Adjustment Assistance -Workers program. Procedures to limit cash draws to the minimum amounts needed to carry out the program and to request and deposit funds as close as possible to the time of making disbursements will include:

- analysis of prior week's disbursements, as well as patterns and trends, to determine the amount of funds to draw down for the following week;
- posting of deposits and disbursements on a daily basis to ensure cash balances are reasonable; and
- monitoring the status of scheduled provider payments and federal cash balances to lime the cash draws as close to the actual cash outlays as administratively feasible.