

MOHAVE
EDUCATIONAL SERVICES COOPERATIVE



Detailed Response
to the
Auditor General's Investigative Report
on
Mohave Educational Services Cooperative

Rev. November 17, 2004

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November 17, 2004

Debra Davenport
Auditor General
State of Arizona
2910 N. 44th Street,
Suite 410
Phoenix, AZ 85018

Dear Debra,

Included with this cover letter is our response to your March 2004 release of your investigation findings for Mohave Educational Services Cooperative. I believe that good professional audits can be a tool to improve an organization. As you can see from our responses, Mohave Educational Services Cooperative is concerned with the reporting of facts, accuracy, and statements regarding the investigation by your office. It is my hope that you will place a copy of our responses to your findings on your website.

Contrary to the statements in your investigation, Mohave does perform a valuable service for Arizona schools and other government agencies. If it were not for Mohave Educational Services Cooperative, millions of dollars would have to be spent on purchasing goods and services, rather than be part of the classroom budget.

Despite our differences, Mohave will always be willing to work professionally with your office to ensure that our contracts meet Arizona statutes, the Arizona Procurement Code, and the Department of Education rules. Meeting the needs of our members has always been, and will continue to be, paramount at Mohave.

Sincerely Yours,

James F. Migliorino
Executive Director

Summary of Mohave's Responses

Summary Response to Finding 1: MESC follows applicable procurement statutes and rules

The Auditor General's investigation reviewed old contracts that have expired. The investigation found several deficiencies in MESC's contracting program. Those deficiencies were primarily documentation issues. A review of more recent contracts would demonstrate that the deficiencies have been corrected.

All factual deficiencies were corrected before or during 2000. Several of the reported deficiencies were not factual, and inclusion may have resulted from documentation weaknesses. MESC has improved its documentation of procurement actions and will continue to make improvements as they are identified.

Recent legislation enables MESC to operate as a nonprofit corporation for the purpose of administering a cooperative purchasing program. MESC will assume this form of governance in January 2005. MESC will continue to comply with the rules, regulations and statutes applicable to public procurement under its new form of governance.

Summary Response to Finding 2: MESC contracts provide economic value for its members

The report did not provide objective documentation to support the statements that MESC's practices of using the competitive sealed proposal method of source selection and awarding multiple contracts resulted in high prices.

The pricing analysis in the report did not consider like procurements and contained errors.

A number of MESC prices were lower than those of other entities.

A number of alleged overcharges were incorrect.

Overcharges appear to result from mistakes, not willful misconduct.

MESC has revised its internal audit procedures to include review of products, services and prices included on selected member purchase orders. This review is in addition to the sample price verification performed by MESC's Procurement Specialists when they process member purchase orders. The new procedure will enable MESC to help members ensure that products or services purchased, and the prices paid, under MESC contracts are in compliance with those contracts.

Summary Response to Finding 3: MESC charges members equitably

MESC does not subsidize ASPIN operations. ASPIN has been completely self-supporting since FY2002.

All members, including those in Mohave County, pay a fee for use of MESC contracts.

MESC members do not subsidize purchases made by Cooperative Educational Services (CES) members. Members of CES, the New Mexico purchasing cooperative, do not purchase from MESC contracts.

MESC did not withhold prompt payment discounts from members. Prompt payment discounts were contractually assigned to MESC. MESC used its own funds to qualify for prompt payment discounts.

While MESC disputes the findings that it failed to properly charge Mohave County members and CES, MESC is revising its policies for these entities to more accurately reflect its position as a statewide cooperative purchasing program with statewide governance.

Summary of Mohave's Responses (cont'd)

Summary Response to Finding 4: MESC complies with the financial practices believed to be applicable to its operations

MESC's salary and benefits are based on ranges of comparable school districts with like fiscal responsibility.

Prior to the Auditor General's report, MESC was never instructed to follow Mohave County's Merit System Rules and Regulations.

MESC's governance and operation practices were reviewed and approved by legal counsel several times prior to the Auditor General's report.

MESC consistently followed the USFR because it is a school service agency. MESC's financial practices have consistently been in compliance with the USFR and MESC policy.

The salary analysis compared a number of disparate positions and used outdated information.

The employee benefits analysis contained outdated information.

With the change to a nonprofit corporation, any questions as to the policies and procedures that govern MESC and its operations will be resolved in accordance with Title 10 of the Arizona Revised Statutes. As a nonprofit corporation, MESC will continue to follow sound fiscal, operational and human resources policies and procedures.

Summary Response to Finding 5: Other MESC operations are proper

MESC purchased property in accordance with direction from the Mohave County Attorney.

MESC does not follow the UAMAC because it applies to county government.

As a school service agency, MESC based its financial records and reporting on the USFR.

All MESC funds, including the revolving fund, are established in accordance with MESC policy.

Over the past eight years, MESC has implemented a number of procedures and practices to ensure segregation of duties and proper fiscal controls.

MESC disposes of assets in accordance with MESC policy.

MESC is resolving property and other assets ownership with Mohave County. With the change to a nonprofit corporation, MESC's operations will be governed by, and in compliance with, Title 10 of the Arizona Revised Statutes. As a nonprofit corporation, MESC will continue to follow sound financial reporting and operational policies and procedures.

Summary and impact of the report

The Auditor General began the investigation in August 1999. The final visit to MESC was in late 2001.

More than two years elapsed between the investigators' last trip to MESC and release of the report.

MESC received a copy of the report with minimal prior notice before its release, and was not afforded an opportunity to include a formal response.

A number of known improvements to MESC's practices and procedures were not included in the report.

MESC's response to the report addresses a number of errors and use of outdated information.

An email from the Auditor General's office to schools, County School Superintendents and independent CPA firms has resulted in a number of misconceptions.

Summary of Mohave's Responses (cont'd)

Summary and impact of the report (cont'd)

Many findings in the report were based upon the Auditor General's determination that MESC is an entity of Mohave County government, and is subject to Mohave County rules, regulations and oversight. While MESC disagrees with that position, it has obtained legislation that settles the governance issue by authorizing MESC to operate as a non-profit corporation for the purpose of providing a cooperative purchasing program.

MESC believes several of the findings resulted from inadequate documentation. MESC understands the value of good documentation and will improve its documentation on a going forward basis. MESC will respond with revised practices to other areas of the report that revealed opportunities for improvement.

MESC has provided valuable services to Arizona for more than 30 years. We plan to continue service to our members as an improved organization.

MOHAVE'S RESPONSE TO FINDING 1

MESC FOLLOWS APPLICABLE PROCUREMENT STATUTES AND RULES

The report alleged the following improprieties in MESC's contracting program:

- MESC inappropriately used the competitive sealed proposal method of source selection
- Vendor responses were not properly evaluated
- No determination of price being fair and reasonable
- Improper multiple awards

MESC's response to each of the allegations follows.

MESC'S USE OF COMPETITIVE SEALED PROPOSALS IS APPROPRIATE AND COMPLIES WITH APPLICABLE RULES AND STATUTES

The Auditor General's allegation is based upon two assumptions. First, MESC's governing authority failed to determine that competitive sealed bidding was not practicable or advantageous for any of the proposals MESC has issued. Second, the competitive sealed bidding method of procurement likely would have resulted in lower contract prices.

MESC's Executive Board has routinely authorized use of competitive sealed proposals. Documentation of such approval is included in Executive Board Meeting Minutes as far back as August 1995.

On August 18, 1995, the MESC Executive Board authorized staff to divide future RFPs into two classes. Class I would include RFPs schools asked MESC to initiate. Class II would include those proposals MESC initiated.

For Class I solicitations, the Executive Board authorized staff to issue a RFP without prior Executive Board approval, as long as procurement requirements were met. Class II solicitations required prior Executive Board approval.

MESC staff followed the Executive Board's direction. Executive Board Meeting Minutes routinely contain authorization to issue RFPs. The general terms and conditions of MESC requests for proposals documented the Executive Board's actions and stated the basis for the Executive Board's determinations.

In the year 2000, MESC changed to the more common practice of having the Executive Board specifically approve determinations that competitive sealed bidding was not practicable or advantageous. Such determinations are made on a class basis and comply with the Arizona State Board of Education School District Procurement Rules (Procurement Rules).

The Auditor General's allegation that use of competitive sealed bidding would likely have resulted in lower contract prices is subjective and unsubstantiated. The only supporting documentation is a statement that the Arizona State Procurement Office (AzSPO) uses the competitive bid process whenever it is possible to quantify factors and clearly define specifications. Notwithstanding that statement, no analysis of similarities and/or differences in MESC's and AzSPO's purchasing programs is provided to establish a standard of comparison between the two entities.

There are considerable differences in the MESC and AzSPO contracting programs. AzSPO's contracting program is designed primarily to meet the procurement requirements of the State. Those requirements are much more defined than MESC's. Availability of AzSPO contracts to other entities is essentially a courtesy. Those entities often have little, if any, influence on the terms of the contract, the specifications and scope of work, or the award decision. Conversely, MESC contracts are designed specifically for a diverse statewide membership of more than 700 entities. Those requirements are difficult to specifically define and quantify and still properly address the members' needs. To best meet the requirements of such a diverse membership, the competitive sealed proposal method of source selection often provides the most advantageous solution.

Notwithstanding differences in the scopes of their procurement programs, MESC and AzSPO both use competitive sealed proposals as the common method of source selection. AzSPO's use of proposals was substantiated in an Arizona Capitol Times article on June 4, 2004. In that article, John Adler, State Procurement Administrator, indicated that, "Most contracts, however, are not awarded through strictly competitive bidding. They're awarded following a review of proposals. Here, price isn't the only factor." Mr. Adler also indicated that, "A company's resources, track record and quality of proposed work are considered as well. For that reason, when the state solicits business, it announces requests for proposals more often than requests for bids."

While the competitive sealed proposal process is more subjective than competitive sealed bidding, it is not a methodology that ignores the importance of price, delivery, warranty, and other key considerations. Instead, it provides a means to compare these important factors in order to determine the most advantageous solution. Such a solution provides excellent value, in addition to fair and reasonable pricing. MESC has always included price considerations in its evaluations and awards. This helps ensure fair and reasonable prices for the scope and nature of the contract.

MESC PROPERLY EVALUATES VENDOR OFFERS

MESC evaluations and awards are based solely on consideration of the evaluation criteria set forth in the competitive procurement solicitation. At best, the Auditor General identified technical deficiencies in and lack of thorough documentation for MESC solicitations issued during the period 1993 through early 1999. Had the review included more current solicitations, the investigators would have found the deficiencies were corrected in mid-2000.

The report faults MESC for not listing the evaluation criteria for its RFPs in relative order of importance, as required by the procurement rules. MESC corrected that deficiency with RFP 00G-0929, issued on August 28, 2000, and all RFPs issued thereafter.

The report further states that failure to list the evaluation criteria in relative order of importance *may* result in proposals that do not accurately reflect the performance requirements. (emphasis added) However, the report fails to provide evidence supporting that subjective position.

The report refers to the "omission of evaluation criteria." MESC solicitations have never omitted the evaluation criteria. As stated above, MESC evaluations and awards are based solely on consideration of the evaluation criteria set forth in the competitive procurement solicitation.

The Auditor General faults MESC's Evaluation Checklist, and indicates that contract awards were *often* unsubstantiated by, or in conflict with the Evaluation Checklist forms. (emphasis added) The report fails to provide the following critical information associated with use of the MESC Evaluation Checklist:

- The Evaluation Checklist was revised in 2000 to obtain more specific responses from members. The revisions included "Yes" and "No" checkboxes for each item and elimination of the "No Opinion" option.
- The Auditor General's characterization that contract awards were *often* unsubstantiated by or in conflict with the Evaluation Checklist forms appears to be based upon only five instances.
- The report appears to purposely omit positive comments from evaluators because none are provided, but are known to exist.
- The report fails to determine if the negative comments from evaluators were correct. It is quite common for evaluators to develop differing opinions on certain evaluation criteria. A price determined by one evaluator to be "exorbitant," may in fact be the going rate for the applicable products or services.
- Members have always been informed that MESC made the final determinations for award. Those determinations are always based upon the award criteria.

Finally, MESC began documenting all award recommendations in writing in 2000. Such written recommendations comply with the Procurement Rules.

MESC DETERMINES THAT PRICES ARE FAIR AND REASONABLE

While the Auditor General uses a general headline to infer that MESC fails to determine that any of its prices are fair and reasonable, the report solely addresses situations where only one bid or proposal was received for a specified solicitation category. This is apparently based upon the Auditor General's position that when only one bid or proposal was received, MESC failed to determine that the bidder's price was fair and reasonable and that other prospective bidders had reasonable opportunity to respond, or there was inadequate time to resolicit the proposal.

The Auditor General's position appears to be based upon absence of written determinations that the price was fair and reasonable and that other prospective bidders had reasonable opportunity to respond, or there was inadequate time to resolicit the proposal in those instances when only one bid or proposal was received. However, no evidence is provided to substantiate that MESC failed to make the required determination. While the Procurement Rules do not specify that such determinations be in writing, MESC acknowledges the benefits of good documentation, and began preparing written determinations to support award of single bids or proposals in 2000. Those determinations comply with the Procurement Rules.

The report contends that failure to determine that the bidder's price was fair and reasonable and that other prospective bidders had reasonable opportunity to respond, or there was inadequate time to resolicit the proposal, *may* have limited competition and resulted in less than the best possible results in terms of both quality and cost. (emphasis added) That subjective position is substantiated solely by comments from several vendors who reported that they were unable to respond to a solicitation for roofing services because of its restrictive language. However, the vendors' comments do not in any way indicate that MESC received a bad bid or awarded a bad contract.

The following additional information is also pertinent to the roofing bid.

- The prospective bidders also indicated the Hypalon flashing specified in the solicitation was proprietary to a single manufacturer. While researching the specifications for a new roofing solicitation, MESC determined the Hypalon flashing is not proprietary to one manufacturer. Additionally, the solicitation contained provisions for other types of flashing.
- The prospective bidders indicated that they were not familiar with a bid that did not contain specifications for a specific project. They appeared to want the ability to "walk the roof" prior to bidding. That is not possible with MESC bids.
- In preparing its latest roofing solicitation, MESC had two school facilities managers review the specifications and scope of work. Both found the specifications and scope of work to be fair and reasonable.
- MESC opened new roofing bids on Friday, April 2, 2004. Four bids were received.

Finally, because the Auditor General's review was of old contracts, the review failed to show that competition increases with each new MESC solicitation. The increased competition can be attributed to the value of a MESC contract, and promotes better pricing for the members.

MESC'S MULTIPLE AWARDS ARE PROPER

The Auditor General alleged that MESC's practice of awarding multiple contracts for the same goods or services *may* be inhibiting the economic value of competition. (emphasis added) However, the only evidence to support that position is a comparison of furniture prices in Finding 2. MESC will demonstrate in its response to Finding 2 that the price comparison contained errors that affected the results, and that there is no evidence that a multiple award inhibited competition.

The State Board of Education School District Procurement Rules and the State Procurement Rules define a multiple award as “an award of an indefinite quantity contract for 1 or more similar materials or services to more than 1 bidder or offeror.” (R7-2-1001-54, R2-7-301-12) MESC’s use of multiple awards fits into this definition as all MESC contracts are for indefinite quantities for one or more similar materials or services to more than 1 bidder or offeror.

The State Board of Education School District Procurement Rules provide no direction as to the use of multiple awards. However, it has long been accepted that by defining multiple award, the State Board of Education anticipated its use, and made multiple awards available to school districts.

Generally, school districts have been advised that multiple awards may be used when a school district can document that multiple awards are advantageous to the district. However, in its April 2001 newsletter, the Auditor General indicated that school districts generally “should not use multiple awards allowing more than one vendor to supply the same goods or services.” The newsletter included the following exceptions:

- Multiple awards may be made if one vendor is unable to provide the total quantity requested by the district or if different vendors would be used for different geographical regions to obtain the best price.
- Multiple awards may also be used to award different items to separate vendors when the items were included in the same invitation for bids (IFB). However, the IFB should clearly state whether multiple awards may be used so that bidders can take this into consideration when pricing their bids.

The guidance in the first exception does not appear to match the definition of multiple award, as it at least partially applies to fixed quantity contracts. While this appears to be practicable advice for a single school district with defined requirements, it does not apply to MESC’s statewide procurement program where requirements are not easily defined or quantified.

The second exception appears to apply to the use of competitive sealed bidding, again for a single school district. However, MESC appears to comply with that requirement because all MESC procurement solicitations indicate that multiple awards may be used.

The report cites a State Procurement Rule (R2-7-308), but does not address how it is applicable to MESC’s purchasing program. MESC believes the rule is not applicable to its contracts. That rule comes from the Arizona Administrative Code, Title 2, Chapter 7, which applies to State procurement. Notwithstanding that fact, the requirements of the rule and MESC’s response are as follows:

R2-7-308 Multiple-source Contracting

- A. If the procurement officer anticipates that any of the awards described in subsections (B) through (D) of this rule will be made, the solicitation shall include a notification of the right of the state to make such an award and the criteria upon which such an award will be based.

MESC’s solicitations indicate that Mohave reserves the right to make multiple awards to ensure that contracts meet the requirements of all members.

- B. An incremental award may be made only if the procurement officer determines in writing that such an award is necessary to obtain the required quantity or delivery.

MESC does not make incremental awards.

- C. A multiple award shall be made only if the procurement officer determines in writing that a single award is not advantageous to the state. A multiple award shall be limited to the least number of suppliers necessary to meet the requirements of the using agencies.

When used, MESC documents in writing that multiple awards are advantageous to members and provides the basis for the determination. MESC awards contracts to the fewest number of vendors determined necessary to meet the members’ requirements. Note that the rule does not require a written determination for the number of vendors awarded contracts. However, based upon issuance of a revised Cooperative Procurement Practices Questionnaire in May 2004, and a conversation with a representative of the Auditor General’s office in September 2004, MESC now documents that multiple awards are limited to the fewest number of suppliers determined necessary to meet the members’ requirements.

- D. A regional award may be made only if material or service is required to widely scattered locations or a particular requirement is of a local nature.

MESC seldom awards regional contracts. However, when used, MESC's regional awards comply with this requirement because of MESC's statewide membership and applicable local requirements and/or considerations.

Because old contracts were reviewed, the report fails to acknowledge that MESC's current award practices limit the number of common awards (i.e., multiple awards for the same manufacturer). When multiple offers are received for the same manufacturer, MESC determines the most advantageous offer, and awards the contract to that vendor. The same philosophy applies to competitive sealed bids where the contract is awarded to the lowest responsible and responsive bidder to the common manufacturer. There are only limited instances when a major manufacturer is awarded to more than one vendor. The basis for the award is documented in those instances.

MOHAVE'S RESPONSE TO FINDING 2

MESC CONTRACTS PROVIDE ECONOMIC VALUE FOR ITS MEMBERS

The report alleged the following deficiencies associated with the value of Mohave contracts:

- MESC contracts may cost more.
- Negligent oversight of members' purchases.

MESC CONTRACTS PROVIDE EXCELLENT VALUE FOR MEMBERS.

The Auditor General compared prices for five commodities for which MESC and AzSPO contracted. The report alleged the contracts to be for similar procurements. However, the report failed to mention, and apparently consider, the following:

- MESC prices were standard contract prices. AzSPO prices were for large dollar procurements for the Arizona School Facilities Board (SFB) deficiencies correction program.
- The report failed to consider volume discounts available on MESC contracts.
- MESC offered to seek additional volume discounts for the SFB deficiencies purchases. The offer was declined by the SFB.
- The price comparisons contained a number of errors that affect the outcome of the analysis.

Basketball Goal Equipment

- AzSPO prices were based upon an estimated purchase of 1,636 pieces. MESC prices were standard single unit prices.
- The report incorrectly lists the MESC contract price for the ACI BA-3SB at 199.77 (\$221.97, less 10%). The correct MESC contract price was \$186.54 (\$207.27, less 10%).
- The report references purchases of \$4.35M from Norcon's MESC Contract 97D-1024 for FY98-FY00. That volume of purchases was not for the specified items.

School Furniture (Artco-Bell)

- AzSPO prices were based upon an estimated purchase of 1,818 student pieces and 452 teacher & aide pieces. MESC prices were standard single unit prices.
- The report incorrectly compares MESC and AzSPO contract prices for the CD60 and CD36 computer tables. MESC's prices included wire management; AzSPO's apparently did not. With the cost of wire management removed, MESC's prices were \$168.70 for the CD60 (\$189.43-\$14.73) and \$136.97 for the CD36 (\$149.89-\$12.92).
- With corrected computer table prices, MESC pricing was lower than AzSPO pricing on 6 of 8 items, the same on 1 item and \$0.40 higher on the remaining item. See the summary below.
- The majority of MESC purchases for the specified time frame were for products with chrome frames. The AzSPO contract apparently did not offer that option.
- The report references purchases of \$5.70M from Arizona School Furnishings' MESC Contract 99A-0122 for March FY99-FY00. That volume of purchases was for all items under contract, and was not limited to the specified items.

Product	MESC Price	AzSPO Price	Difference \$	Difference %
Artco-Bell 7103 stacking chair, painted frame	<i>\$12.15</i>	\$12.19	(\$0.04)	-0.33%
Artco-Bell 7105 stacking chair, painted frame	<i>\$14.00</i>	\$14.31	(\$0.31)	-2.21%
Artco-Bell 7107 stacking chair, painted frame	\$15.90	\$15.90	\$0.00	0.00%
Artco-Bell 7457 student desk, painted frame	<i>\$45.95</i>	\$46.80	(\$0.85)	-1.85%
Artco-Bell H457 student desk, painted frame	<i>\$78.73</i>	\$78.88	(\$0.15)	-0.19%
Artco-Bell 9500 student desk, painted frame	<i>\$28.06</i>	\$28.40	(\$0.34)	-1.21%
Artco-Bell CD60 computer table	\$168.70	<i>\$168.30</i>	\$0.40	0.24%
Artco-Bell CD36 computer table	<i>\$136.96</i>	\$139.40	(\$2.44)	-1.78%
☐	<i>\$500.45</i>	\$504.18	(\$3.73)	-0.92%

Low price in bold italics.

School Furniture (Virco)

- AzSPO prices were based upon an estimated purchase of 1,818 student pieces and 452 teacher & aide pieces. MESC prices were standard single unit prices.
- The majority of MESC purchases for the specified time frame were for products with chrome frames. The AzSPO contract apparently did not offer that option.
- The report references purchases of \$1.74M from Virco's MESC Contract 99A-0122 for FY99-FY00. That volume of purchases was for all items under contract, and was not limited to the specified items.

Apple Computers

- AzSPO prices were for the SFB deficiencies correction purchase. Those prices were not AzSPO contract prices, but were based upon a separate quotation process valued at up to \$50M. MESC prices were standard single unit prices.
- Apple computers in the price comparison were not available under AzSPO contract prior to the SFB volume purchase.
- The report references purchases of \$35.06M from Apple's MESC Contract 97-0321 for FY97-FY00. That volume of purchases was for all items under contract, and was not limited to the specified items.

Printers

- MESC standard contract prices were lower across the board.
- The report references purchases of \$36.10M from Dell's MESC Contract 98-0306 for FY98-FY00. That volume of purchases was for all items under contract, and was not limited to the specified items.

Dairy & Food Products

- The report stated that MESC administrative fees were not included in the milk prices. There is no MESC administrative fee for the dairy contract. The administrative fee referenced in the report is only applicable for food and supply contracts.
- Prior to FY2001, ASPIN had one price for all schools regardless of geographic location. FY2001 was the first year ASPIN requested pricing by zones to lower milk costs for all members. Requesting pricing by zones and then by county, has resulted in lower prices for all ASPIN members.
- As additional schools have joined ASPIN and zones have been restructured, ASPIN dairy pricing has become even more competitive.
- Douglas' food service was provided in 2001 by a contracted food service management company. The company charges a fee for their services. That fee may considerably reduce or negate the savings.

MESC's Summary of the Price Analysis

The report's price comparison is flawed for the following reasons:

- It failed to consider differences in circumstances surrounding the procurements.
- It failed to acknowledge that MESC contract prices were lower than AzSPO prices for a number of products, even though AzSPO prices were based upon specified quantity purchases and MESC prices were standard contract prices.
- It failed to acknowledge that MESC contract prices would have been lower when purchases qualified for quantity discounts available in some of the furniture contracts.
- It failed to acknowledge that the computer prices in the comparison were not AzSPO contract prices, but were based upon a separate quotation. Notwithstanding that oversight, MESC prices were within 1.62% of the AzSPO volume prices, without MESC having the benefit of seeking additional volume discounts from its contractors.
- It contained pricing errors that skewed the analysis.

The report was highly critical of MESC prices. However, it failed to find fault with AzSPO pricing that exceeded comparable prices in MESC contracts. MESC is not critical of AzSPO prices. We only point out that the report's criticism was apparently one sided.

The report faulted MESC's use of multiple awards for similar products. However, it failed to fault AzSPO's use of multiple awards for furniture. It appears that AzSPO found it advantageous to award several furniture products to more than one vendor, just as MESC did with its furniture contracts.

The report indicates that MESC charges a 1%, \$10 minimum, administration fee for each purchase, and that AzSPO requires an annual \$160 fee to purchase from state contracts. No additional analysis regarding administration fee is provided.

MESC understands that AzSPO's annual fee is designed to cover the cost of the website used by AzSPO's cooperative purchasing members. Other costs of operating the State Procurement Office, salaries, benefits, facilities, insurance, supplies, utilities, vehicles, equipment, telecommunications, training, postage, advertising, etc., are budgeted from State of Arizona funds.

MESC's 1% administrative fee pays for all costs associated with MESC's operations; salaries, benefits, facilities, insurance, supplies, utilities, vehicles, equipment, telecommunications, training, postage, advertising, etc. MESC receives no direct tax levy and has no other budget source to support its operations.

MESC is a member of the Association of Educational Purchasing Agencies (AEPA), a group of purchasing cooperatives from 21 states that combine their requirements for national contracts. One percent is the lowest administrative fee among all AEPA members. MESC has researched administrative fees among other purchasing cooperative around the country, and found that MESC's 1% fee is the lowest among cooperatives providing comparable contracts and services.

Savings Studies

The report faulted MESC's savings studies for limited analysis and flawed methodology. Similar faults can be found in the Auditor General's analysis of prices. The Auditor General relied on an extremely limited sample of five commodity items. The Auditor General did not use comparable contracts. The Auditor General's analysis contained numerous errors.

MESC is not aware of any other purchasing cooperative in the state that attempts to review savings and other benefits achieved from use of its contracts. While the report was critical of the methodology used for MESC's savings surveys, it did not dispute the findings. Those surveys confirm that members obtain excellent value and other benefits from use of MESC contracts.

MESC IS NOT NEGLIGENT IN ITS OVERSIGHT OF MEMBER PURCHASES.
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The Auditor General faulted MESC's review of member purchases based upon the following:

- MESC rarely verifies that member purchases comply with the terms of the contract.
- MESC failed to confirm that products and prices on member purchase orders complied with the terms of applicable contracts.
- MESC's failure to verify contract compliance allowed a vendor to overcharge members.

MESC's response to each of those allegations follows.

MESC's review of member purchase orders is a unique service among purchasing cooperatives used by Arizona public entities.

The Auditor General faulted MESC for failure to verify contract compliance for member purchases. This is based upon MESC's position that it performs such verification and the Auditor General's finding that such verification was rarely performed.

The report reads as if the finding is applicable to current practices. However, the Auditor General's review was limited to a very small sample of old purchase orders.

MESC's Procurement Specialists review member purchase orders prior to issuing corresponding purchase orders to the contractors. The reviews are used to confirm that members are using valid contracts, and that ordering, shipping and billing information is in order.

The Procurement Specialists also check selected purchase orders for contract compliance, including verification of a sample of the products and prices. Those purchase orders that pass this test are marked with a “PRICE CONFIRMED” stamp. Purchase orders that fail the test are held for further review, correction or return. The report failed to acknowledge that the investigators were informed of the practice of testing sample purchase orders, not every member purchase order.

To the best of its knowledge, MESC has been the only purchasing cooperative serving Arizona public entities that performs any purchase order review for members. AzSPO, WSCA and U.S. Communities do not see purchase orders issued by members under their cooperative contracts. Therefore, buying entities commonly rely solely on contractor representations for contract compliance. While the report finds fault with MESC’s purchase order verification, historically, MESC is the only purchasing cooperative to provide any level of purchase order verification to Arizona public entities.

The Auditor General report purported that “Because MESC regularly promotes that it makes sure its members’ purchase order prices match its contracts, MESC created a “fiduciary duty to ensure that all purchases are in compliance with contract terms.” However, the report failed to indicate that MESC has never told members that they were absolved from their ultimate responsibility to ensure compliance with applicable procurement requirements. In fact, MESC has no authority to offer such absolution, and has always been forthcoming with that fact.

The report also failed to address MESC’s internal audit of member purchases. That audit is performed prior to closing member purchase files, and is used to confirm that the member and MESC purchase orders match, and that billing and payment match the purchase orders. MESC’s internal audit has resulted in recovery of funds for members on a number of occasions. To the best of our knowledge, MESC is the only cooperative offering internal audit of member purchases.

MESC’s internal audit process has been revised to include review of products, services and prices included on selected member purchase orders. This review is in addition to the sample price verification performed by MESC’s Procurement Specialists. The new procedure will enable MESC to help members ensure that the products or services purchased, and the prices paid, under MESC contracts are in compliance with those contracts.

The report of alleged overcharges contains errors. Overcharges resulted from mistakes, not willful misconduct.

The Auditor General’s report made a blanket statement about negligent oversight resulting in member overcharges. However, that finding was limited to review of contracts with a single vendor, who was apparently targeted on the basis of allegations made by former employees of that vendor. Additionally, MESC found errors in the analysis and determined that the investigators made non-contract assumptions in support of their findings.

MESC reviewed the analysis of the fifteen purchase orders in the report. A table showing the monetary outcome of MESC’s review and a detailed response to the Auditor General’s analysis of all fifteen purchase orders follows.

MESC review of Alleged Member Overcharges

PO #	Invoice Total (from AG Report)	MESC Determined Overcharge	AG Determined Overcharge	Difference
1	\$309,899	\$0	\$0	\$0
2	\$315,228	\$0	\$0	\$0
3	\$148,665	\$4,704	\$7,277	(\$2,573)
4	\$55,521	\$0	\$9,545	(\$9,545)
5	\$386,378	\$25,768	\$39,745	(\$13,977)
6	\$150,109	\$0	\$10,650	(\$10,650)
7	\$53,567	\$2,237	\$13,691	(\$11,454)
8	\$11,923	\$2,100	\$2,100	\$0

MESC review of Alleged Member Overcharges (cont'd)

9	\$307,347	\$14,765	\$66,081	(\$51,316)
10	\$10,223	\$648	\$800	(\$152)
11	\$99,914	\$0	\$15,540	(\$15,540)
12	\$134,022	\$0	\$9,877	(\$9,877)
13	\$200,007	\$0	\$0	\$0
14	\$75,019	\$0	\$0	\$0
15	\$85,464	\$0	\$0	\$0
Total	\$2,343,286	\$50,221	\$175,306	(\$125,085)

MESC's response to the report's purchase order review.

Parts of this review respond to information in the working papers for the report. That information, while not part of the final report, is an integral part of the investigators' findings.

• **Purchase Order 1**

On a 1995-96 purchase of bleachers, seating and backboards, the investigators indicated that they were unable to determine why three invoices exceeded the purchase order amount. MESC reviewed the procurement file and found that the total of all invoices matched the purchase order amount.

• **Purchase Order 2**

On a 1996-97 purchase of doors, the investigators indicated that they were unable to determine why invoices exceeded the purchase order amount. MESC reviewed the procurement file and found that the total of all invoices matched the purchase order amount.

• **Purchase Order 3**

On a 1996 purchase order for lockers, scoreboards, backstops, seating, etc., the investigators allege that the member was overcharged in the amount of \$7,277.00 because promotional pricing was not applied to the purchase and MESC allowed freight and installation charges when such charges were included in contract prices.

MESC reviewed this purchase and found that promotional pricing was not applied and resulted in an overcharge of \$4,701.63. The overcharge apparently resulted from a mistake in pricing and not willful misconduct. Following MESC's standard practice, the amount of the overcharge will be recovered from the vendor on the member's behalf.

The investigators allege the member was charged for installation and freight when such charges were included in contract prices. MESC reviewed the vendor's proposal, which formed the basis of the contract, and found that freight (estimated at 8%-12% of cost, depending on manufacturer) and installation were allowable charges. It appears that the vendor failed to charge freight and installation on a number of the products, an oversight that benefited the member. Freight of 14% was charged for one product, resulting in an overcharge of approximately \$8.30. However, the member saved substantial money from the vendor's failure to charge freight on the other products. Therefore, there was no collectable overcharge for freight and labor on this purchase.

The investigators based some findings on bleacher and seating pricing upon other categories in the contract. Those categories included specified products for which freight and installation were included in contract prices. Such pricing was limited to the specified products. However, the investigators apparently carried the terms of pricing for the specified items through to other products from the same manufacturers and manufacturers of similar products. For example, because freight and installation were included in the price of a specified set of outdoor portable bleachers, the investigators apparently determined that freight and installation were included in pricing for all bleachers, regardless of manufacturer, type or product number. Such an application of terms was not in compliance with the contract.

- **Purchase Order 4**

On a 1997 purchase order for bleachers, the investigators allege the member was overcharged in the amount of \$9,545.00 because promotional pricing was not applied to the purchase and MESC allowed freight and installation charges when such charges were included in contract prices.

MESC reviewed this purchase and found that the promotional pricing was not applicable because both the member and MESC purchase orders were issued in 1997. The May 3, 1996, promotional pricing letter referenced in the report clearly indicates that, “This is a very significant benefit and is available for all MESC members *through calendar year 1996.*” (emphasis added) Therefore the member was not overcharged for the bleachers.

The investigators allege the member was charged for installation and freight when such charges were included in contract prices. MESC reviewed the vendor’s proposal, which formed the basis of the contract, and found that freight (estimated at 12% of cost) and installation were allowable charges. The member was charged much less than 12%, a significant savings. Therefore, there was no overcharge for freight and labor on this purchase.

- **Purchase Order 5**

On a 1997 purchase order, the investigators allege MESC’s PO references an incorrect MESC contract number, the purchased items were not part of the contract at the time of purchase, and the member was overcharged in the amount of \$39,065.60 for the building and \$680.00 for crane rental. The investigators also questioned the charge for performance and payment bonds, and reconciliation between PO and invoices.

Listing the wrong contract number on the purchase order was an error that had no impact on the purchase. It was an inadvertent error, not willful misconduct.

The vendor quoted the building prior to MESC approving the pricing. This is a contract violation that apparently resulted from a mistake, not willful misconduct. The vendor has been notified of this violation, and MESC will take the action it deems most appropriate for the situation.

It is evident from documentation in the purchase file that MESC caught the error and did not issue a purchase order until it was corrected. This position is substantiated by the lapse in time between member’s purchase order date (1/8/97) and the date MESC issued its purchase order (6/5/97).

MESC contracts allow products to be added under specified provisions. It is not known at this late date whether MESC failed to place documentation that it added the building in this purchase order to the contract, or determined that an addition was not necessary because the purchase was based upon an existing building with an added module at the price thought to be in accordance with the contract.

The report faults the use of an Option Price List that was received by MESC on 5/23/97. That Option Price List is dated October 1, 1996, and clearly indicates it applies to the contract. All that can be determined from the copy in the Auditor General’s report is that MESC received a copy of the Option Price List on 5/23/97. However, it is clear that MESC considered the options to be part of the contract.

MESC accepted the vendor’s “best and final” pricing as submitted. No recalculation was done to confirm the square foot price. As a result, any evaluation of the purchase should be in accordance with pricing in the contract. Based upon this position, MESC believes the member was overcharged in the amount of \$25,088.00 ((4,480 sq. ft. x \$49.90 = \$223,552)-\$248,640). The amount of the overcharge will be collected from the vendor on the member’s behalf. MESC will also collect the \$680 overcharge for the crane.

The report pointed out the value of confirming pricing that is submitted in multiple forms (i.e., a fixed total cost and unit price for the same item). MESC will use such confirmation as part of future pricing analysis.

The investigators appear to question charges associated with performance and payment bonds for this project. The terms of the contract required that the vendor provide performance and payment bonds upon request from the buying member. It appears the member requested bonds for this project. Bonds

were issued directly to the member as owner of the project. There is no evidence from the member that it did not receive the bonds.

MESC reviewed the purchase and determined that the member was invoiced and paid the correct amount.

- **Purchase Order 6**

On a 1997 purchase order for bleachers, the investigators allege the member was overcharged in the amount of \$10,650.00 because promotional pricing was not applied to the purchase and MESC allowed freight and installation charges when such charges were included in contract prices.

MESC reviewed this purchase and found that the promotional pricing was not applicable because both the member and MESC purchase orders were issued in 1997. The May 3, 1996, promotional pricing letter referenced in the report clearly indicates that, "This is a very significant benefit and is available for all MESC members *through calendar year 1996.*" (emphasis added) Therefore the member was *undercharged* because the 25% promotional discount was applied. The correct contract price should have been \$125,502.27 (10.5% off the July 1996 pricelist). The error benefited the member. Therefore, there was no overcharge on this purchase.

The investigators allege the member was charged for installation and freight when such charges were included in contract prices. MESC reviewed the vendor's proposal, which formed the basis of the contract, and found that freight (estimated at 12% of cost) and installation were allowable charges. The member was charged much less than 12%, a significant savings. While the quote for installation did not match the price methodology used in the contract, there is no evidence that the member was overcharged. Therefore, there was no overcharge for freight and labor on this purchase.

- **Purchase Order 7**

On a 1997 purchase order for bleachers, the investigators allege the member was overcharged in the amount of \$13,691.00 because promotional pricing was not applied to the purchase and MESC allowed freight and installation charges when such charges were included in contract prices.

MESC reviewed this purchase and found that the promotional pricing was not applicable because both the member and MESC purchase orders were issued in 1997. The May 3, 1996, promotional pricing letter referenced in the report clearly indicates that, "This is a very significant benefit and is available for all MESC members *through calendar year 1996.*" (emphasis added) Therefore the member was *undercharged* because the 25% promotional discount was applied. The correct contract price should have been \$40,751.14 (10.5% off the July 1996 pricelist). The error benefited the member.

The investigators allege the member was charged for installation and freight when such charges were included in contract prices. MESC reviewed the vendor's proposal, which formed the basis of the contract, and found that freight (estimated at 12% of cost) and installation were allowable charges. The vendor's summary sheet indicates freight and installation of costs \$8,784.00, \$2,057.67 more than the amount provided in MESC's price analysis. Since MESC used the amount of \$6,726.33 in its analysis, we will collect \$2,236.61 from the vendor on the member's behalf.

- **Purchase Order 8**

On a 1997 purchase order for outdoor bleachers, the investigators allege MESC allowed the vendor to improperly substitute a manufacturer that was not under contract and overcharge the member in the amount of \$2,100 for freight charges.

MESC had no knowledge of the product substitution prior to reviewing the Auditor General's report. It appears the vendor substituted a manufacturer due to a dispute with the awarded manufacturer. The intent was to supply the bleachers to the member without unnecessary delay. Because the vendor substituted without approval from MESC, a contract violation occurred. The vendor has been notified of this violation, and MESC will take the action it deems most appropriate for the situation.

The investigators allege the member may have been overcharged for installation, based upon a 6/93 price sheet which specified that installation was included in the specified prices. MESC reviewed that price sheet and found that it applied to specific products. Additionally, at this late date, there is no way to determine if those prices were still in effect in 1997. The general Aalco price sheet did not specify that installation was included in contract prices. Therefore, there is no documented overcharge for installation.

The investigators allege the member was overcharged for shipping. While shipping was an allowable charge under the contract, the terms of the contract indicate that the vendor could not charge a member more than its actual freight charges. The manufacturer's quote indicates that delivered prices were offered. Unless the vendor can substantiate that the freight cost charged to the member was tied to shipment from the vendor's to the member's location, MESC will collect \$2,100 from the vendor on the member's behalf. It should be noted that without possession of the manufacturer's quote, MESC would have no knowledge of the delivered price quote.

- **Purchase Order 9**

On a 1997 purchase order for a modular building, the investigators allege improper product additions and miscalculations resulted in member overcharges. Included are:

- Overcharge of \$26,206.40 on base building price.
- Overcharge of \$23,867.00 for restrooms and teachers lounge.
- Overcharge of \$13,113.00 for ground source heat pumps.
- Overcharge of \$2,625.00 on exterior doors.
- Overcharge of \$270.00 for exhaust fans in restrooms.
- Overcharge of \$43.80 in admin fee.

The report faults the vendor for issuing a proposal to the member before the product was under contract. The vendor issued a proposal to the member on 5/9/97. The vendor submitted a copy to MESC on the same date and requested that MESC add the new building to the contract. Offering the proposal to the member prior to the item being under contract is a technical violation of the contract. However, it is evident that the vendor intended to have the building under contract before proceeding with the member. In fact, the vendor noted in its proposal that it had submitted a copy of the proposal to MESC as a request to add the building to the contract. The vendor has been notified of this violation, and MESC will take the action it deems most appropriate for the situation.

The report faults the use of an Option Price List that was received by MESC on 5/23/97. The Option Price List is dated October 1, 1996, and clearly indicates it applies to the contract. All that can be determined from the copy in the Auditor General's report is that MESC received a copy of the Option Price List on 5/23/97. However, it is clear that MESC considered the options to be part of the contract.

The member's purchase order was issued to MESC on May 12, 1997. MESC's purchase order was issued to the vendor on July 14, 1997. The delay resulted from MESC's efforts to obtain proper documentation for the purchase.

It is clear from the more than 2 months that passed between receipt of the member's purchase order and issuance of MESC's purchase order, and all correspondence between MESC and the vendor prior to issuing the MESC purchase order, that MESC had no intention of issuing a PO unless and until the specified modular and options were under contract. Therefore, the statement that the specified items were not under contract is incorrect. At most, MESC's documentation was not as thorough as it should have been for a review several years after the fact.

The report misstates the contents of a vendor letter dated July 15, 1997. According to the report, the letter indicates that the basis for pricing the building in this purchase was the average cost per square foot for buildings already under contract at the time. However, the letter actually indicates that "budget" numbers provided to the member in September 1996 were based upon average cost per square foot for buildings then under contract. In no way does the letter indicate that average cost per square foot was used to price the new building. Additionally, the letter is an explanation of events for the procurement, not a request to add product to the contract.

Documents officially requesting addition of the building in this purchase make no statement about average cost per square foot being the basis for determining the cost. In fact, a letter from the vendor dated June 27, 1997, explains that the cost per square foot is slightly higher than the standard 56x64 duplex and provides the reason for the difference. Based upon the documentation presented by the vendor, MESC determined it could add the building in accordance with the terms of the contract.

The price submitted by the vendor and accepted by MESC was used for the member's purchase. Therefore, there was no overcharge on the base building.

The investigators allege that the base price included restrooms, and the member should not have incurred additional charges for restroom and lounge fixtures. The June 27, 1997, letter also indicates that the base price of \$56.30 per square foot, or \$227,000 total, is for the base floor plan. It is evident from the cost of the other buildings on the contract, that floor space for the restrooms and teachers lounge are included in the base price, but not the plumbing and fixtures. Therefore, there was no overcharge for the restroom and lounge fixtures.

The investigators allege that the member was overcharged for a ground source heat pump because wall mounted heat pumps were included in the base building specification. The ground source heat pump is not a wall mount heat pump. It is a specialized unit that uses geothermal energy, and is clearly not a standard heat pump. Therefore, the upgrade charge for the ground source heat pump was allowable.

While not stated in the report, the investigators allege the member was entitled to a credit for deletion of the standard HVAC system. This is based upon the Option Price List for Heating, Ventilation and Air Conditioning, which indicates that "For purposes of equipment substitution, a credit of \$900 per ton may be utilized." The standard HVAC system provided a 3 ton electric heat pump for each 900 square feet of classroom space. If applicable to this building, the credit would equal \$12,096 $((4,032 \text{ sq ft}/900) \times 3) \times \900 .

MESC does not believe the credit is applicable to the ground source heat pump because the Option Price List indicates the price of such a system is \$846/ton, *over and above base heat pump system*. (emphasis added) However, the vendor has agreed to allow the credit, and MESC will collect \$12,096 from the vendor on the member's behalf.

Based upon discrepancies in the specifications and Option Price List, the vendor has agreed to reimburse the member for the exterior door upgrade. MESC will collect \$2,625 from the vendor on the member's behalf.

The contract indicates that exhaust fans are provided in standard classroom buildings. The restrooms in this complex were an add-on. As such, the member was not overcharged for the exhaust fans.

Member overpaid the administrative fee by \$43.79. The overpayment was the direct result of the member erroneously issuing the \$75,000 progress payment directly to the vendor. MESC will credit or refund \$43.79 to the member.

- **Purchase Order 10**

On a 1997 purchase order for outdoor bleachers, the investigators allege MESC allowed the vendor to improperly substitute a manufacturer that was not under contract and overcharge the member in the amount of \$800 for freight charges.

MESC had no knowledge of the product substitution prior to reviewing the Auditor General's report. It appears the vendor substituted a manufacturer due to a dispute with the awarded manufacturer. The intent was to supply the bleachers to the member without unnecessary delay. Because the vendor substituted without approval from MESC, a contract violation occurred. The vendor has been notified of this violation, and MESC will take the action it deems most appropriate for the situation.

The investigators allege the member may have been overcharged for installation, based upon a 6/93 price sheet which specified that installation was included in the specified prices. At this late date, there is no way to determine if those prices were still in effect in 1997. The general Aalco price sheet

did not specify that installation was included in contract prices. Therefore, there is no documented overcharge for installation.

The investigators allege the member was overcharged for shipping. While shipping was an allowable charge under the contract, the terms of the contract indicate that the vendor could not charge a member more than its actual freight charges. The manufacturer's quote indicates that delivered prices were offered. Unless the vendor can substantiate that the freight cost charged to the member was tied to shipment from the vendor's to the member's location, MESC will collect \$648.00 from the vendor on the member's behalf. It should be noted that without possession of the manufacturer's quote, MESC would have no knowledge of the delivered price quote.

- **Purchase Order 11**

On a December 1997 purchase order for bleachers, the investigators allege that the member was overcharged in the amount of \$15,540.00 because promotional pricing was not applied to the purchase.

MESC reviewed this purchase and found that the vendor's special pricing letter was written on November 18, 1997, and received by MESC the same day. The pricing was to be effective through November & December 1997. The letter did not specify a contract number. However, at the time of the letter, MESC had only one bleacher contract with the vendor, and that contract was replaced on December 19, 1997.

The member's purchase order was received after implementation of the replacement contract, which was awarded on December 19, 1997. The purchase was applicable to that contract.

The vendor could not offer a pricing promotion on a non-existent contract. Inclusion of the promotion in the replacement contract would have required that the promotion be specifically added to that contract. That did not happen. Because the promotion was not added to the replacement contract, it was not applicable to the member's purchase, and there was no overcharge.

The Auditor General believes the promotion should have applied to any purchase made during the specified period, regardless of effective dates of contracts. MESC finds no contractual basis with which to enforce such a position. The Auditor General also believes that the promotion should apply because a copy of it was found in the replacement contract. MESC found no such copy in the replacement contract.

- **Purchase Order 12**

On a 1998 purchase order for bleachers, lockers, basketball goals, and a gym divider curtain, the investigators allege the member was overcharged in the amount of \$9,877. The basis of the allegations and MESC's responses follow.

The investigators allege the member was overcharged in the amount of \$2,451 for bleachers because promotional pricing was not applied. They also allege overcharges of \$3,100 for installation of lockers and \$2,825.64 for basketball goals because quoted prices were not applied to the purchase order.

The promotion on the bleachers expired many months before the member issued its purchase order to MESC. The contract applicable to the lockers and basketball goals was replaced well before MESC received the member's purchase order. In all three instances, MESC properly applied the prices in effect at the time of purchase.

The investigators allege that quotation date should govern prices on this purchase, regardless of the status of a promotion or contract at the time of purchase. Such a position appears to have no enforceable basis because MESC cannot hold a contractor to something that is no longer in effect, i.e., a pricing promotion or contract. The only known exception would be a purchase that was in place, but not completed prior to expiration of the promotion or contract. That exception does not apply to this purchase.

Notwithstanding quotation dates, MESC does not have purchase authorization from a member until the member's purchase order is received by MESC. Because this purchase order was received after

expiration of the promotion and replacement of the original contract, the pricing in the purchase order was correct and there was no overcharge to the member.

The investigators allege the member was overcharged \$1,500 for a gym divider curtain. The finding is apparently based upon the Auditor General's receipt of price worksheets in 2000. However, multiple purchase orders issued by the member in 1998 confirm that the member authorized the higher charge. This authorization was based upon a reconfiguration requested by the superintendent. Based upon the available information, the member was not overcharged.

- **Purchase Order 13**

On a 1998 purchase order, the investigators allege the contractor made an unauthorized product substitution.

MESC had no knowledge of the product substitution prior to reviewing the Auditor General's report. It appears the vendor substituted a manufacturer due to a dispute with the awarded manufacturer. The intent was to supply the bleachers to the member without unnecessary delay. Because the vendor substituted without approval from MESC, a contract violation occurred. The vendor has been notified of this violation, and MESC will take the action it deems most appropriate for the situation.

- **Purchase Order 14**

On a 1998 purchase order, the investigators appear to have concerns over the documentation associated with this purchase order.

The purchase description could have been more detailed to match the quote. However, this appears to have been a technical error, as there is no evidence that the procurement was not completed as desired.

- **Purchase Order 15**

On a 1998 purchase order, the investigators allege that MESC improperly added Sport Court flooring without competitive bidding.

While MESC contracts authorize product additions under specified provisions, Sport Court flooring may have been added to the contract in error. This was done in 1996. Current practices help prevent improper additions to contracts.

Early in its cooperative purchasing program, MESC accepted contractor quotes, as submitted, to substantiate member purchases. This is common for purchases made under cooperative contracts, and was in place for many of the purchase orders reviewed in the Auditor General's report.

In order to better protect the members' interests, MESC began requiring vendors to submit detailed quotes that better prepared MESC and its members to confirm contract compliance. This was implemented a number of years ago, as a normal course of improving service.

MESC's testing of sample member purchase orders provides a level of member service not offered by most other cooperatives. As a result of purchase order testing, the requirement for detailed quotations, and internal audit review of all purchase files, MESC provides a high level of member confidence. MESC will continue to refine and improve member protection procedures.

MOHAVE'S RESPONSE TO FINDING 3 MESC CHARGES MEMBERS EQUITABLY

As a school service agency, MESC is required to share its administrative and general services costs on a user basis. The Auditor General's report alleged MESC failed to meet this requirement due to the following:

- MESC subsidizes food operations.
- Some members are not assessed fees.
- MESC improperly retains discounts.

MESC NO LONGER SUBSIDIZES ASPIN OPERATIONS

ASPIN became part of MESC at the members' request. As with many start-up operations, ASPIN operated at a deficit in its early years. To provide the program with an opportunity to succeed, MESC covered ASPIN's early operating losses. This was accomplished with MESC funds. No additional fees were assessed to MESC members.

Because the report was based on a dated review, it failed to indicate ASPIN's current financial condition. Beginning with FY2002, ASPIN's operating revenues have been sufficient to cover its operating expenses. ASPIN is not only completely self-supporting, it has repaid to MESC all funds used to cover prior operating losses and developed an abeyance fund to cover future shortfalls, if any.

The following information substantiates ASPIN's position as a successful operation:

- ASPIN's membership is growing because of exceptional pricing and service.
- A financial analysis performed for each new ASPIN member demonstrates a substantial savings with membership.
- Growth in membership and refined contracting have lowered ASPIN prices.
- ASPIN reduced maintenance fees by 35% for all members in FY2005, thus increasing savings for all members.

ALL MEMBERS ARE ASSESSED FEES

The report alleged that MESC's failure to charge Mohave County members and members of a New Mexico purchasing cooperative administrative fees resulted in Arizona members outside of Mohave County subsidizing MESC operations.

Most Mohave County school districts are members of MESC's film service. The film service provides educational videos to Mohave County schools on a loaned basis.

Members of the film service pay an annual fee to MESC. A number of years ago, the MESC Executive Board approved a plan to include the administrative fee for MESC contract purchases by members of the film service in the annual film service fee. The plan was reviewed and approved in advance by the Mohave County Attorney.

Mohave County entities that are not members of the film service pay the standard one-percent administrative fee on all purchases from MESC contracts. One example of a Mohave County member that pays the one percent administrative fee is Lake Havasu City.

MESC believes its method of assessing fees for film service members was appropriate and allowable. However, beginning July 1, 2004, MESC started collecting film service and cooperative purchasing administrative fees from film service members as separate charges. This was done in recognition of MESC's statewide presence as a cooperative purchasing program, local film service, and a desire to clearly account for all fees and charges.

Cooperative Educational Services (CES) in Albuquerque, New Mexico is a sister purchasing cooperative. MESC and CES have been partners for many years.

Under New Mexico law, CES has the ability to piggyback off of MESC contracts. To facilitate such piggybacking, MESC asks vendors responding to MESC solicitations if they would be interested in extending the pricing offered in their bids and proposals to CES members. If the vendors indicate interest by checking a box in the solicitation, they are instructed to submit an additional copy of their bid or proposal. After MESC awards contracts, CES copies of all successful bids or proposals are shipped to New Mexico at CES' expense.

Once the vendor-supplied CES copies are shipped to New Mexico, MESC ends its involvement with CES for that solicitation. CES establishes and manages its own contracts, using applicable MESC bids and proposals as the basis for pricing. CES manages all of its member purchase orders. CES addresses any claims or controversies associated with its contracts.

MESC has absolutely no contractual or operational obligation for any CES contract. MESC solicitations are based solely upon the requirements of MESC's members. CES has no influence or impact on the commodities or services for which MESC contracts. CES has no influence or impact on the terms, conditions or specifications in MESC solicitations. CES has no influence or impact on the bidders lists for MESC solicitations. CES has no influence or impact on administration of MESC contracts, including procurement timing, contract renewal, contractor status, etc.

Because CES has no influence or impact on its contracting program, MESC has never charged a usage-based administrative fee to CES or its members. Additionally, both CES and MESC benefited equally from any increase in economies of scale that resulted from their combined purchasing opportunities.

MESC believes it is compensated for all costs incurred for CES use of Mohave contracts when CES pays the cost of shipping extra proposal copies to New Mexico. However, in light of the Auditor General's report, MESC will work with CES to determine an appropriate methodology for clearly accounting for any and all administrative costs associated with the partnership. All such costs will be reimbursed by CES.

MESC DOES NOT IMPROPERLY RETAIN DISCOUNTS

The Auditor General alleged that MESC retained prompt payment discounts that could be credited to members. As a result, the report alleged that members paid MESC up to five percent of the value of their purchases.

The Auditor General alleged that MESC must pass the benefit of prompt payment discounts on to members, if members paid MESC within the specified payment discount timeframe. The basis for this position appears to be that MESC recovered its administrative costs via the 1% administrative fee paid on all purchases. Therefore, MESC is not entitled to raise any additional funds via prompt payment discounts.

The report's analysis of prompt payment discounts is incorrect for the following reasons:

- The terms of MESC contracts require that any prompt payment discount be made directly to MESC. The following excerpts from MESC solicitations substantiate this position.

Terms in effect for reviewed contracts

Payment Discounts: Any payment discount offered must be made directly to MESC and not to the member or affiliate member receiving the materials or services. Because MESC must process a voucher through the Mohave County School Superintendent's Office, after receiving payment from the member or affiliate member, MESC has limited control of timeliness of payment. Quick-payment discounts of 10 days are normally impossible; 20 and 30 days are more reasonable. Payment discounts of forty-five (45) calendar days or more shall be deducted from the bid price to determine low bid.

MESC's current solicitations contain similar language, which is provided below. Again, the language clearly states that payment discounts must be made directly to MESC.

Current General Terms & Conditions

Payment discounts: Any payment discount must be made directly to MESC and not to member receiving the materials or services.

- The sample used in the Auditor General's analysis was too small to provide an accurate finding.
The report indicated that members paid invoices within the prompt payment window about 26 percent of the time. However, the report's finding was based upon a sample of 117 invoices. MESC issues more than 20,000 invoices annually. The report's sample was not sufficient for proper analysis.

- Member payment was seldom received in time for MESC to process vouchers through the Mohave County Treasurer's Office and pay the vendor within the specified payment discount timeframe.

The obligations of an entity using a MESC contract remain with that entity. That includes the obligation to pay for purchased goods and services. When considering payment timing for member access to payment discounts, the clock cannot be stopped when MESC receives payment from the member (as apparently was done in the Auditor General's analysis). At that point, the member's obligation to the vendor continues because the vendor has not received its payment. The payment discount clock stops when the vendor receives payment from MESC, generally 7-10 days after Mohave receives payment from the member.

MESC received the benefit of payment discounts solely because MESC used its funds to pay the vendor within the specified payment discount window. MESC did not place members at risk with this practice because MESC would lose the discount if the vendor received its payment after the discount deadline. Even if MESC lost the discount, there would be no additional cost to the member. Likewise, the member was not entitled to benefit from MESC's financing of the discount.

- Payment discounts were only one part of recovering administrative costs of operating MESC's cooperative purchasing program.

It appears that prompt payment discounts were viewed as additional profit for MESC, based upon the assumption that MESC recovered its administrative costs through the one percent administrative fee. However, that assumption was not correct.

ARS §15-365 requires that using entities pay the administrative costs of a school service program. Additionally, The Arizona Administrative Code authorizes the public procurement unit furnishing informational or technical services in a cooperative procurement program to request reimbursement for the reasonable and necessary costs of providing such services. (R7-2-1191-5)

Methodologies for recovering the costs of a cooperative purchasing program are not specified. MESC's 1% administrative fee is its primary means for recovering the costs of the cooperative purchasing program.

MESC is not limited to the administrative fee. When fiscally sound, MESC uses payment discounts as a means to recover the cost of its cooperative purchasing program. This benefits members by helping control growth of the administrative fee.

While the report alleged that MESC received about \$60,000 per year in prompt payment discounts, it failed to specify the period of time for that finding. There were many years when MESC did not benefit from prompt payment discounts because the cost of obtaining them exceeds the amount of funds received.

- Offering payment discounts to members would result in additional administrative costs.
Members are currently allowed 25 days to pay MESC's invoice. In order to reasonably expect member payment in time to beat the payment discount deadline, MESC would be required to shorten its 25-day payment time. This would burden more members than it benefited.

Additionally, those members who took a payment discount from MESC's invoice, but did not leave MESC with enough time to pay the vendor within the discount timeline, would be required to make an additional payment for the lost discount. This would delay payment to vendors who are already waiting 45 days for payment. The net result would be lost contracts or increased prices. Neither of which benefits members.

It is also very difficult to get public agencies to make additional payments on closed purchase orders. MESC would incur additional costs for recovering payment for lost payment discounts. Those additional costs would be passed on to the members.

The report faulted MESC for not notifying members that the discount was available, and that MESC, not the member, would receive the benefit of the discount if the member paid within the specified timeframe. This is apparently based upon the belief that such knowledge would impact the members' purchase decisions.

Such logic is circular, and appears to serve no purpose other than to confuse and incite the member. Notifying members of a contract provision that does not pertain to them should not influence a purchase decision. That decision should be based upon analysis of the value of the contract's terms and prices. Additionally, the terms associated with payment discounts were not secret agreements between MESC and its contractors. The terms are included in every MESC procurement solicitation. Members have been reviewing those terms for years, and never made an issue of them.

The allegation that some members paid MESC five percent of certain purchases is incorrect. Payment discounts were never available to members. Therefore, such discounts cannot be considered part of the cost to members.

The report inaccurately indicated that the terms of MESC solicitations require that discounts for payments received after 45 days be reflected in the contract price. The applicable contract language actually stated that "Payment discounts of forty-five (45) calendar days or more shall be deducted from the bid price to determine low bid." It did not state that contract prices would be reduced.

The apparent intent of that language was to indicate to vendors that MESC anticipated making all payments within the 45 days specified in the solicitation. Therefore, it was assumed that any discount offered after 45 days would apply to all purchases. However, MESC found that it could not reliably assure payment within 45 days, often due to circumstances beyond its control. As a result, MESC never deducted such discounts from bid prices to determine low bid. Doing so may have given an unfair advantage to certain vendors. The language was removed from MESC solicitations because it was not used.

MESC's application of payment discounts complies with applicable contract terms. Such discounts remain a viable option for managing the cost of administrative fees. MESC will develop and publish a clearly stated policy to help insure that members are fully informed of its use of prompt payment discounts.

MOHAVE’S RESPONSE TO FINDING 4
MESC COMPLIES WITH THE FINANCIAL PRACTICES BELIEVED TO BE
APPLICABLE TO ITS OPERATIONS

The Auditor General’s report alleged a number of improprieties in MESC’s financial practices, including:

- Payment of excessive salaries and benefits.
- Travel benefits beyond policy limits.
- Improper benefits and gifts.

MESC’s response to each of the allegations follows.

MESC DISAGREES WITH THE BASIS FOR THE REPORT’S FINDING OF FINANCIAL IMPROPRIETIES

The Auditor General’s report found that MESC is subject to Mohave County oversight, rules and regulations. Because of that finding, the report stated that MESC violated a number of Mohave County rules and regulations, including Mohave County merit system rules and regulations and travel policy.

MESC has been in continuous operation since 1971, and has operated as Mohave Educational Services Cooperative since 1981. The Mohave County School Superintendent established MESC as a school service agency under A.R.S. § 15-365. MESC has consistently followed rules and regulations using the same standards as school districts because it has been defined as a school service agency. This includes use of the USFR, MESC Board Policy Manual, Arizona Procurement Code, and the procurement rules established by the Arizona State Board of Education. This operational structure was developed under guidance from the Mohave County Attorney and MESC’s legal counsel.

Mohave County has never taken an active role in MESC’s operations. The County provides no tax support, facilities, or direction on financial or procurement laws and rules. The report’s statement that the Mohave County Supervisors approve MESC’s budget is incorrect. The County receives a copy of MESC’s budget, as well as other annual reports, but takes no action on the documents.

MESC has operated for over 30 years following legal opinions issued by the Mohave County Attorney and MESC’s own legal counsel. No one told MESC it should have been following Mohave County rules and regulations until the Auditor General released the findings of its investigation. Had MESC been so informed, issues in this area would have been resolved long before the Auditor General’s investigation.

An independent certified public accounting firm audits MESC financial operations annually. The audits are based upon the requirements of the USFR, and include completion of the USFR Compliance Questionnaire. The Auditor General has approved MESC’s RFPs for procurement of financial and compliance audits and audit contracts, and received copies of all audits. Until release of the report, the Auditor General never questioned the validity of MESC’s use of the USFR, its financial reporting, or other audit issues.

MESC SALARIES AND BENEFITS ARE NOT EXCESSIVE

The finding that MESC salaries and benefits were excessive was apparently based solely on the determination that MESC was subject to Mohave County Merit System Rules and Regulations and the unsubstantiated subjective opinion that MESC employees had less fiscal and administrative responsibility than Mohave County employees.

MESC’s salary and benefits are based on ranges of comparable school districts with like fiscal responsibility. Prior to the Auditor General’s report, MESC was never instructed to follow Mohave County’s Merit System Rules and Regulations. Notwithstanding the report’s finding, MESC continues to believe that under ARS §15-365 it has the ability to determine its own merit rules with approval from the

Mohave County School Superintendent. This position is in compliance with a letter from the Mohave County Attorney in 1990.

The report faulted MESC for salaries substantially higher than equivalent jobs in Mohave County government. Since the investigation, Mohave County performed a market study that resulted in recommendations for substantial increases in a number of salaries used in the report's analysis. A review of the County's current salary schedule shows the following changes in maximum salary:

Position	Report Maximum Salary	Current Maximum Salary
County Manager	\$97,739	\$138,632
Chief Financial Officer (Financial Services Dir)	\$54,475	\$93,849
Purchasing Dir/Procurement/Central Svcs Mgr	\$48,485	\$73,528
Senior Buyer	\$37,336	\$45,115
Computer Services Coordinator Senior	\$31,408	\$42,952
Office Assistant Senior	\$27,997	\$35,339
Office Assistant Clerk	\$25,688	\$32,052
Administrative Supervisor	\$48,485	\$57,616 or \$66,705

The chart above substantiates that Mohave County salaries were below market value at the time of the investigation and that the current salary schedule shows much more comparable salaries between MESC and Mohave County.

MESC believes the report's analysis of MESC and Mohave County salaries compared disparate positions, including the following.

- MESC's Ass't. Executive Director to the County's Ass't. County Manager
The County's current salary schedule does not include the position of Ass't. County Manager. MESC's Ass't. Executive Director serves as MESC's Chief Operations and Human Resources Officer. The only comparable County position title in the salary schedule is Human Resources Director (maximum salary 93,849).
- MESC's Contracts Manager and the County's Senior Buyer
MESC found no comparable position title in Mohave County's salary schedule.
- MESC's Accounting Manager and the County's Office Assistant Senior
Using position titles in Mohave County's salary schedule, it appears potentially comparable County positions include Accountant Senior (maximum salary 57,616) or Finance Officer (maximum salary 54,870).
- MESC's CIS Manager and the County's Computer Services Coordinator Senior
Using position titles in Mohave County's salary schedule, it appears potentially comparable County positions include Network Services Manager (maximum salary 70,033) or Information Technology Director (maximum salary 98,550).

In early summer 2004, Mohave County department heads told the Board of Supervisors that they were unable to recruit and retain employees, particularly college graduates, because of low salaries. Since that time, at least one elected county official has described the situation as approaching the crisis point. MESC has been successful in recruiting and retaining well-qualified employees because it offers good salaries and benefits.

A number of MESC salaries in the report belonged to long-term senior management employees. Since the investigation, those employees have retired, or soon will retire. Salaries for new employees in those positions will be lower than the salaries listed in the report.

No current MESC employees receive tax sheltered annuities. MESC personal, vacation, sick and bereavement leave allocations comply with MESC policy. MESC has never followed Mohave County's leave allocation and accrual policy. Prior to the Auditor General's report, MESC was never instructed to follow Mohave County's leave allocation and accrual policy.

MESC leased vehicles for two administrative employees. Those employees traveled many highway miles in performance of their assigned duties. Both employees chose to drive MESC-leased vehicles in lieu of receiving vehicle allowances. Both employees paid a portion of the cost of those vehicles.

In 2003, MESC discontinued the practice of allowing employees who constantly travel in performance of their duties to choose a leased vehicle in lieu of a vehicle allowance. MESC has one vehicle remaining under lease. That lease expires in 2004, upon which time MESC will no longer lease vehicles.

The report alleged that MESC received at least 15 holidays per year, instead of the 11 holidays authorized for Mohave County. MESC's holiday schedule for the last three years is as follows:

- FY2002 14 holidays 260 work days
- FY2003 13 holidays 261 work days
- FY 2004 13 holidays 262 work days

MESC's holiday schedule is comparable to Arizona schools districts. MESC has never followed Mohave County's holiday schedule. Prior to the Auditor General's report, MESC was never instructed to follow Mohave County's holiday schedule.

The report alleged that MESC spent more than \$41,000 from FY1997 through FY1999 on food, lodging and other travel-related expenses that were in violation of Mohave County's travel policy. MESC travel complies with the policy and reimbursement rates published by the Arizona Department of Administration. MESC has never followed Mohave County's travel policy. Prior to the Auditor General's report, MESC was never instructed to follow Mohave County's travel policy.

The report alleged that MESC failed to retain receipts for many purchases that totaled to over \$9,000. MESC's response to that statement is as follows:

- MESC complies with the Records Management Manual for Arizona School Districts, and maintains receipts in accordance with that manual.
- MESC attaches receipts to purchase orders or other appropriate backup documentation.
- MESC attaches receipts for airline tickets and other travel expenses to the annual American Express or other applicable purchase order.
- MESC attaches receipts for travel incidentals, i.e., parking, cab fare, registration fees, to individual travel claims.
- Because MESC had no Auditor General request on file for receipts, MESC disposed of the majority of purchase files associated with the \$9,000 in expenditures referenced in the report.
- MESC still has the purchase files for several of the referenced expenditures because those expenditures were for general fixed assets. Those receipts total \$959.70.

The report alleged that MESC improperly disbursed certain benefits to themselves, other government officials and vendors. The allegation is tied to the Auditor General's review of expenses MESC incurred in relation to annual employee inservice, public relations and recognition efforts.

MESC believed those expenditures complied with the Arizona Constitution and Attorney General Opinion I85-051. For example, the County School Superintendent's staff received a box of candy each year in recognition of their prompt processing of MESC warrants. MESC believed that the value the public received from prompt payment of vendor invoices and MESC payroll processing for a full year far exceeded the cost of a box of candy. However, it appears MESC may have been deficient in its documentation of those expenditures. MESC will improve documentation for future expenditures.

MESC's change to a nonprofit corporation will provide a means to clearly address and resolve all governance issues. As a nonprofit, MESC will comply with the requirements of Article 10 of the Arizona Revised Statutes. Even though it will no longer be a public entity, MESC is committed to maintaining fair and reasonable fiscal, operational and human resources policies and procedures. An elected Board of Trustees, formal policies, annual and periodic membership meetings, and formal financial reporting will help ensure complete compliance.

MOHAVE'S RESPONSE TO FINDING 5 OTHER MESC OPERATIONS ARE PROPER

The Auditor General's report alleged a number of improper operations, including:

- Unlawful property ownership.
- Noncompliance with UAMAC.
- Improper revolving fund.
- Improper disposal of assets.

MESC's response to each of the allegations follows.

MESC RECEIVED AUTHORIZATION TO PURCHASE PROPERTY

The Auditor General alleged that because MESC is an entity of Mohave County government, MESC had no authority to purchase and hold title to real property. That finding is contrary to authorization issued by the Mohave County Attorney.

For many years, MESC was housed in World War II facilities owned by the Mohave Union High School District. In 1991, those facilities ceased to be adequate, and MESC requested guidance from the Mohave County Attorney as to several options for replacement facilities. One of those options was MESC's purchase of real property. The Mohave County Attorney indicated that he saw no legal barrier to MESC's purchase of permanent facilities. MESC's purchase of real property was guided by that authorization.

The report alleged that MESC improperly insured its real property through the Arizona School Risk Retention Trust. The finding is apparently based upon the determination that the Mohave County Board of Supervisors was responsible for insuring the property in the name and to the benefit of Mohave County.

Prior to the Auditor General's report, MESC was never instructed it could not own property. MESC's property is titled to Mohave Educational Services Cooperative. Therefore, it would appear that the Board of Supervisors was under no obligation and had no authority to insure the property.

MESC FOLLOWS THE USFR

The report alleged that MESC failed to follow the Uniform Accounting Manual for Arizona Counties (UAMAC). UAMAC is the county government equivalent to the USFR, which is followed by school districts.

Prior to the Auditor General's report, MESC was never instructed to follow UAMAC. Notwithstanding the report's finding, MESC continues to believe that under ARS §15-365 it has the ability to follow the USFR with approval from the Mohave County School Superintendent. This position is in compliance with direction from the Mohave County Attorney and MESC policy.

MESC'S REVOLVING FUND WAS ESTABLISHED IN ACCORDANCE WITH MESC POLICY

The report alleged that MESC improperly established a revolving fund because the Mohave County Board of Supervisors did not approve that fund. The Auditor General made this determination even though Mohave County did not provide the money or manage the fund.

Prior to the Auditor General's report, MESC was never instructed that the Board of Supervisors was responsible for approving MESC's revolving fund. Notwithstanding the report's finding, MESC continues to believe it properly established the revolving fund in compliance with MESC policy.

The report stated that a MESC employee signed a revolving fund check made payable to himself. MESC has put procedures and practices in place over the past eight years that ensure segregation of duties and proper fiscal controls. Those controls make sure the payee does not sign revolving fund checks.

MESC PROPERLY DISPOSES OF ASSETS

The report alleged that MESC improperly disposed of assets because the Mohave County Board of Supervisors did not approve the disposals. The Auditor General made this determination even though the assets did not belong to Mohave County.

Prior to the Auditor General's report, MESC was never instructed that the Board of Supervisors was responsible for approving MESC's disposal of assets. Notwithstanding the report's finding, MESC continues to believe it properly disposed of assets in compliance with the Arizona State Board of Education School District Procurement Rules and MESC policy.

MESC's change to a nonprofit corporation will provide a means to clearly address and resolve all governance issues. As a nonprofit, MESC will comply with the requirements of Article 10 of the Arizona Revised Statutes. Even though it will no longer be a public entity, MESC is committed to maintaining fair and reasonable financial reporting and operational policies and procedures. An elected Board of Trustees, formal policies, annual and periodic membership meetings, and formal financial reporting and auditing will help ensure complete compliance.

SUMMARY AND IMPACT OF THE REPORT

The Auditor General began its investigation of MESC in August 1999. MESC cooperated fully with the Auditor General's staff throughout the investigation. More than two years elapsed between MESC's last contact with the investigators and release of the report. The report was released with minimal prior notice to MESC and no opportunity for MESC to include a response to the findings.

As a normal course of business, MESC implemented many improvements to its business practices between 1993 (the date of award for the earliest reviewed contract) and 2004 (the year of the report's release). A number of those improvements were in place prior to the investigators' last visit to MESC in 2001, and certainly prior to release of the report. However, the report ignores the improvements and infers that corrected deficiencies still exist.

During the last interviews with the Auditor General's investigators and in conversations with an investigator since release of the report, the Auditor General's staff acknowledged that MESC has made many improvements to its business practices. However, the investigators indicated that the review and report must be limited to a period of time. MESC believes that withholding pertinent information regarding known corrections and improvements fails to serve the public interest.

MESC believes its response demonstrates that the report contains a number of errors and uses dated information that impact the findings. We believe that had MESC been provided with an opportunity to respond to the findings before the report's release, correction of the errors and updating of certain information would have resulted in a much different report.

Since the report's release, MESC made the Auditor General's staff aware of a number of the errors and concerns contained in this response. However, MESC was informed by Auditor General staff that MESC's response will probably not be reported or posted by the Auditor General. MESC finds that to be unfortunate and contrary to the public's best interests.

On March 17, 2004, and in response to the report, the Auditor General's office sent an email to Arizona's schools, County School Superintendents, and independent audit firms, informing them that "...until such time as MESC's current procurement practices are tested by an independent certified public accounting firm and it is determined that MESC has come into compliance with the Rules, it is the responsibility of a member school district/charter school to determine whether their new purchases/contracts through MESC are being made in compliance with the Rules." MESC believes that email has resulted in a number of misconceptions and counterproductive results including the following:

- Members are looking for an imminent finding regarding MESC's current contracting practices.

The referenced review is part of a consent judgment with the Arizona Attorney General. However, MESC must still prepare and issue a solicitation, receive and evaluate proposals, and award a contract before the procurement practices review can begin. It will be some time after that before the audit firm can conduct the review and present its findings.

Soon after the email was issued, MESC requested the acceptable parameters for a review from the Auditor General's staff in order to immediately contract for and begin the review. The Auditor General's staff informed MESC that the parameters would be provided only in conjunction with the consent agreement, in order to manage the resources associated with the investigation. Additionally, the Auditor General advised MESC that it should wait until MESC had entered into an agreement with the Attorney General before contracting for the review.

In light of the above responses, MESC had no means for a prompt initial procurement practices review.

- Members believe the Auditor General is discouraging use of MESC contracts.

While MESC does not read such a position in the email, it is an outcome of the email.

- Members believe use of MESC contracts will place them in jeopardy during their next audit because the Auditor General and independent CPA firms are targeting MESC purchases.

Again, MESC does not read such a position in the email. Additionally, Auditor General staff and independent auditors have stated that such is not the case.

- Members believe that an audit finding related to MESC will automatically result in adverse action by the Auditor General, i.e., a 90 day letter for school districts.

MESC does not read such a position in the email. Auditor General staff have also informed MESC that this is not the case, and that findings will be reviewed and addressed in accordance with the surrounding situation, the information available to the school, and seriousness of any deficiency.

- Members believe the due diligence requirement for determining that contracts comply with applicable procurement rules applies solely to MESC contracts, and exists solely because of the findings in the report.

The cooperative purchasing provisions in the procurement rules and State Procurement Code have never relieved public entities from their responsibility for complying with applicable rules, regulations and statutes. However, the report has brought the need for due diligence to the forefront. Thus, the need for public agencies to use due diligence to make informed and proper cooperative purchasing decisions is neither new nor limited to MESC.

MESC understands member concerns about the time and effort required to perform due diligence contract reviews. To assist members with this effort, MESC has prepared web-based downloadable contract documentation packages that provide the information necessary to efficiently determine that MESC contracts comply with the provisions of applicable rules, regulations and statutes.

- MESC contracts have come under extreme scrutiny, with many different opinions as to the requirements for a proper review.

This is extremely troubling to MESC because MESC contracts have allegedly failed due diligence reviews by CPA's based upon determinations that MESC believes are not substantiated by rule, regulation or statute. With one firm, determinations were based upon requirements in a revised Cooperative Procurement Practices Review Questionnaire of which MESC was not even aware.

- Members found it difficult to make end of year purchases because they are afraid to use the MESC contracts that had been their planned procurement solution.

As a result, MESC saw, and continues to see, a large number of emails being sent in an effort to find any contract that can be used for a member's specific requirements. MESC believes such panic buying will cost more money, which does not serve the public interest.

- Members, particularly schools, are spending valuable funds for independent reviews of MESC contracts.

MESC believes those funds would be better spent on other goods and services because members have already determined the MESC contracts provide the most valuable solution for certain purchases. However, some members are not willing to use MESC contracts without third-party confirmation of applicable rules compliance.

Many of the findings in the report were based on the Auditor General's determination that MESC is an entity of Mohave County government, and is subject to Mohave County rules, regulations and oversight. While MESC disagrees with that position, it has obtained legislation that settles the governance issue by authorizing MESC to operate as a non-profit corporation for the purpose of providing a cooperative purchasing program. A summary of the impact of MESC's change to a nonprofit corporation follows:

- MESC will maintain the same name and same staff
- MESC will continue to be a self-supporting entity
- MESC will be established by Articles of Incorporation
- MESC will develop By-laws to govern its operation
- MESC will continue to be a public procurement unit
- A Board of Trustees will replace the Executive and Advisory Boards
- Members will continue to use the same contract numbers and follow existing procedures for using MESC contracts
- MESC contracts will continue to comply with public procurement rules, regulations, & statutes

- MESC will remain committed to quality service for all members
- MESC will not be governed by or receive services from government officials or agencies
- MESC's Board of Trustees will be elected by the membership
- MESC will operate under the statutes for non-profit corporations
- MESC will continue to follow many of its current business practices (competitive procurement of MESC professional service contracts, compliance with the USFR, annual audits, etc.)
- MESC will continue to purchase, insure and maintain its real and personal property (buildings, grounds, computers, furniture, fixtures, equipment, etc.)

MESC believes several of the findings resulted from inadequate documentation. MESC understands the value of good documentation and will continue to improve its documentation on a going forward basis.

As it has prepared due diligence documentation, MESC has become aware of previously unknown documentation expectations held by Auditor General staff. An example is the revised Cooperative Procurement Practices Questionnaire that MESC's audit firm uses to test MESC's compliance with the procurement rules. The revised questionnaire is dated May 2004. MESC received a copy from an independent audit firm in late June 2004. However, the questionnaire is apparently applicable to audits for FY2004, which began in July 2003.

Prior to receiving the revised questionnaire, MESC's procurement documentation complied with the requirements of the questionnaire issued in June 2000. Once MESC was aware of the requirements in the May 2004 revision, documentation was revised to comply with all new requirements. MESC will do the same as it is made aware of other Auditor General documentation expectations. However, MESC cannot go back and redo existing documentation to comply with requirements that did not exist, or of which MESC was not aware, at the time of preparation.

The report identified areas where MESC can improve. MESC will respond to those areas with revised practices and procedures. The change in MESC's internal audit is an example of a revised practice that improves service.

MESC has provided valuable services to Arizona for more than 30 years. We plan to continue service to our members as an improved organization.