

**STATE OF ARIZONA
OFFICE OF THE TREASURER
Report on Special Investigation
For the Period July 1992
Through October 1992**



DOUGLAS R. NORTON, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

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April 15, 1993

Members of the Arizona State Legislature

The Honorable Fife Symington, Governor

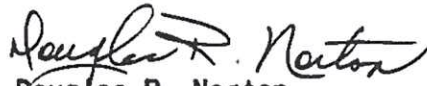
The Honorable Tony West, State Treasurer

We have conducted a special investigation of the State of Arizona, Office of the Treasurer for the period July 1992 through October 1992. Our investigation was performed at the request of the State Treasurer and the Attorney General to determine if public monies had been misappropriated during that period, and if so, the source of the public monies that were misappropriated and the method used.

Our investigation consisted primarily of inquiries and the examination of selected records and other documentation. Therefore, our investigation was substantially less in scope than an audit conducted in accordance with generally accepted auditing standards. Accordingly, we do not express an opinion on the adequacy of the financial records or the internal control structure of the State Treasurer's Office, specifically, or the Arizona Financial Information System II in general, nor do we ensure that all matters involving the internal control structure of either that might be material weaknesses under standards established by the American Institute of Certified Public Accountants or other conditions that require correction or improvement were disclosed.

The accompanying report describes our finding and recommendations as a result of our special investigation.

We express appreciation to the State Treasurer and the Department of Administration for their cooperation and assistance during this investigation. After this report is distributed to the members of the Arizona State Legislature, the Governor, the State Treasurer, and the Attorney General it becomes public record.


Douglas R. Norton
Auditor General

Attachment

cc: The Honorable Grant Woods
Attorney General
J. Elliott Hibbs, Director
Department of Administration

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Summary

On October 21, 1992, a local bank notified the State Treasurer of unusual activity in a personal checking account involving State of Arizona warrants. Based on information provided by the bank, the State Treasurer immediately informed the Attorney General's Office that public monies may have been misappropriated by a State Treasurer's Office employee. Consequently, Wayne Nelson, Administrative Services Officer of the State Treasurer's Office, was indicted and arraigned on 25 felony counts consisting of 18 counts of attempted theft, five counts of theft, and one count each of fraudulent schemes and artifices and computer fraud. On March 30, 1993, Mr. Nelson pled guilty to 10 Class 4 felonies for attempted theft, and is currently awaiting sentencing.

The Attorney General and the State Treasurer requested that the Office of the Auditor General assist in the criminal investigation of the accused. Therefore, in conjunction with the Attorney General's Office, we conducted a special investigation to determine the source and scope of the misappropriation and possible manipulations of the State's accounting systems.

This report presents the results of our special investigation into the misappropriation of public monies by Wayne Nelson. Our investigation included interviews; the evaluation of data from the Arizona Financial Information System II (AFIS II), the Department of Revenue's property tax revenue accounting system, and the State Treasurer's receipt validation system; and a review of evidence obtained from search and seizure warrants.

In July 1992, the Department of Administration implemented AFIS II, a new statewide accounting system. We determined that deficiencies in the implementation of AFIS II and a breakdown in the internal control structure policies and procedures over AFIS II during the implementation period significantly facilitated Mr. Nelson's misappropriation of public monies.

A separate review of the AFIS II system is currently being conducted by our Office. The complete results from that review will be presented at a later date. However, the deficiencies noted to date during that review, as well as those noted during our special investigation, are presented at the conclusion of this report with our recommendations concerning them.

Finding

A public official engaged in a computer fraud scheme to misappropriate public monies.

Wayne Nelson, an Administrative Services Officer at the Office of the State Treasurer, misappropriated \$1,878,687.58 in State monies during October 1992. The fraudulent scheme used by Mr. Nelson involved the manipulation of both the State's AFIS II and Treasurer's Office receipt validation computer accounting systems to divert public monies and to deter the detection of the diversion during the normal course of operations.

During this period three fraudulent entries were made to both the AFIS II and State Treasurer's receipt validation system. The net effect of these entries was to divert a deposit made by the Department of Revenue of \$1,878,687.58 to an inactive Department of Administration Risk Management Pool fund.

On October 9, 1992, Advanced Consulting, a fictitious vendor subsequently used by Mr. Nelson, was added to the AFIS II vendor control file. Between October 9 and 22, 1992, Mr. Nelson input and authorized the issuance of 23 State warrants made payable to Advanced Consulting. The State received no documented benefit for these payments. The 23 warrants, which totaled \$1,878,687.58, were issued from the inactive Risk Management Pool fund.

Mr. Nelson attempted to deposit 10 of the 23 warrants, totaling \$729,774.86, into the fictitious vendor's bank account.

Cause and Recommendations

Deficiencies and a breakdown in certain AFIS II internal control structure policies and procedures during the implementation period, combined with the circumvention of existing controls by Wayne Nelson, so weakened the State's internal control structure relevant to the State Treasurer's Office that the misappropriation of public monies was not readily detectable in the normal course of operations.

The specific weaknesses in the State's internal control structure policies and procedures relevant to the State Treasurer's Office we noted during our investigation and to date during the separate review of AFIS II are presented below. As of the date of this report, only the evaluation of system access and development controls have been completed during our separate review of AFIS II.

1. In July 1992, the Department of Administration implemented a new on-line, real-time accounting and financial reporting system, AFIS II, which allows State agencies to directly input accounting transactions. As a result, some controls over access to the system and data entry functions previously performed by the Department of Administration were decentralized and expected to be performed by the State agencies. The Department of Administration provided training to the agencies prior to the implementation of AFIS II; however, the Department did not provide the agencies with adequate standardized, documented internal control guidelines for these new responsibilities.

To help ensure that only legitimate, appropriate transactions are processed, the Department of Administration should document internal control structure policies and procedures for AFIS II that should be in place at the agency level in the Arizona Accounting Manual and ensure that this manual is distributed to the agencies. At a minimum these controls should address: access to AFIS II, input of transactions, access to warrants and reports, segregation of duties, authorization of transactions, and maintenance of adequate documentation necessary for a sufficient audit trail.

2. The Department of Administration did not establish adequate standard procedures to be followed by agencies obtaining access privileges to AFIS II. In addition, the Department of Administration did not utilize a separate authorization function available through AFIS II. As a result, the agencies could not adequately segregate their access to AFIS II. The Department of Administration also did not require documentation from agencies to ensure the access requested was properly authorized.

We specifically reviewed two types of access codes: global access codes and access codes with the ability to generate warrants. Global access provides the user on-line input and authorization capabilities and access to all State funds, and may be given for one or more transaction types. This access gives the user the ability to process

specified transactions in any agency's funds. We determined that global access codes had only been issued to staff from the Department of Administration and the State Treasurer's Office. There were 30 individual users at these two agencies with global access to disbursement, receipt, journal entry, and transfer transactions. For seven of these users, including Wayne Nelson and another member of the State Treasurer's staff, there was no monitoring or oversight by management.

Access codes with the ability to process warrants provide input and authorization capabilities for disbursement transactions of the user's agency only. There were 576 user identification codes assigned to 81 agencies that had both input and authorization capabilities for issuing warrants, while 56 identification numbers were restricted to input only.

To help ensure that access to AFIS II is effectively controlled, the following policies and procedures should be implemented:

- a. The Department of Administration should issue an AFIS II security policy manual to all State agencies requiring the adequate segregation of specific duties and accesses. The manual should include general guidelines as to the duties and accesses that must be segregated.
- b. The Department of Administration should utilize the AFIS II authorization function so that transaction input and authorization access are segregated for all transaction types and users, including those users with global access. The capability to have input and authorization access by any one user should require written justification from the requesting agency and close, constant surveillance by senior management.
- c. An AFIS II security coordinator should be designated at each agency by the agency head. Ideally, the security coordinator should not have access to cash receipts, accounting records, or warrants. Also, the responsibility for ensuring proper segregation should be placed with the security coordinator at each agency.
- d. An access request form should be developed to ensure access is properly authorized by the agency's security coordinator, and to document the access rights requested. Any request for global access should require written justification from the head of the requesting agency and Department of Administration approval.
- e. The access request form should be retained by the Department of Administration AFIS II Security.

In November 1992, the Department of Administration issued a memorandum to the agencies indicating the need for segregation of access to AFIS II; however, the Department of Administration should coordinate this effort with the agencies to evaluate current accesses assigned, especially for users with global access. Any future policy implementations should be coordinated with the agencies.

3. The Department of Administration's AFIS II implementation plan did not sufficiently address the problems encountered during the system implementation. As a result, as of March 1, 1993, the Department of Administration and the State Treasurer's Office had been unable to reconcile fiscal year 1992-93 activity between AFIS II and the State Treasurer's Office system. The State Treasurer's Office was also unable to clear the error suspense files for deposits made after July 1, 1992. In addition, as of March 1, 1993, some agencies had not submitted to the Department of Administration their conversion of grant balances from AFIS I to AFIS II.

Furthermore, primarily due to these problems, the Department of Administration was unable to issue timely AFIS II reports to the State agencies. Initial monthly reports for July through October 1992 were issued between 15 and 38 days after the end of each month, and one report for September through November 1992 had to be reissued in December 1992. The AFIS II reports issued often could not be reconciled to the accounting records of the State agencies. As of November 1992, several agencies had not been able to reconcile their records to the July 1992 AFIS II reports.

Both the Department of Administration and the agencies should place a greater effort on resolving the reconciliation problems encountered during implementation, as well as anticipating future problems and identifying possible alternate procedures. Also, the Department of Administration should clearly define the responsibilities of both the Department of Administration and the agencies using AFIS II, especially those pertaining to control of liquid assets.

4. In August 1992, due to system-related problems, the Department of Administration deactivated an AFIS II internal system control designed to reject expenditures exceeding the fund's available balance.

The Department of Administration should analyze all internal system controls available, and utilize those controls that would in any way strengthen the internal control structure over State funds.

5. The Department of Administration did not ensure that agency employees picking up warrants agreed the warrants received to the "Warrant Transmittal" sheet. As a result, the Department of Administration accidentally gave State Treasurer warrants to an employee from the Department of Education on October 20, 1992.

To help ensure that warrants are distributed to the proper agencies, the Department of Administration should, at a minimum, require that employees picking up warrants verify the warrants are for their agency before signing the "Warrant Transmittal" sheet.

6. Due to a lack of segregation of duties at the State Treasurer's Office, Wayne Nelson was able to:

- a. Input vendors to the AFIS II vendor control listing
- b. Generate warrants through the on-line input and authorization of claims
- c. Receive warrants
- d. Process most transaction types for all State funds through global access to AFIS II
- e. Review monthly AFIS II reports
- f. Access the State Treasurer's receipt validation system

The State Treasurer's Office should review current AFIS II access and request any modifications necessary to ensure input and authorization capabilities are properly segregated and that global accesses are restricted. Written requests for global access, justifying the necessity and authorized by the State Treasurer, should be submitted to the Department of Administration for approval. Once approval is obtained, global users' activity should be closely monitored by senior management. Employees with the ability to input or authorize claims should not receive warrants.

7. The State Treasurer's Office did not account for the numeric sequence of the receipt validation numbers. Receipt validation is a sequential numbering system used by the State Treasurer's Office to record deposits. A validation number is printed onto each Treasurer's Receipt when the deposit is input into the receipt validation system. At the end of each day when the receipts were batched, the starting and ending validation numbers were noted. However, the subsequent day's starting number was not compared to the ending number from the previous day to ensure the continuity of the sequence.

Wayne Nelson was able to access the State Treasurer's receipt validation system and input three transactions subsequent to the daily "batching." As a result, the validation numbers between the two days' batches contained a gap in sequence, and the missing validation numbers were not noted.

The State Treasurer should verify the numeric sequence of the State Treasurer's receipt validation numbers to ensure that all deposits are properly recorded and accounted for.