A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Management Letter

Apache County

Year Ended June 30, 2001

STATE OF ARIZONA
OFFICE OF THE AUDITOR GENERAL

Debra K. Davenport
Auditor General

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STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

October 15, 2002

Board of Supervisors
Apache County
P.O. Box 428
St. Johns, AZ 85936

Subject: Management Letter

Members of the Board:

In planning and conducting our single audit of Apache County for the year ended June 30, 2001, we performed the following as required by *Government Auditing Standards* (GAS) and Office of Management and Budget (OMB) Circular A-133:

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

There are no audit findings that are required to be reported by GAS and OMB Circular A-133. However, our audit disclosed internal control weaknesses and instances of noncompliance with laws and regulations that do not meet the reporting criteria. Management should correct these deficiencies to ensure that it fulfills its responsibility to establish and maintain adequate internal controls and comply with laws and regulations. Our recommendations are described in the accompanying summary.

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

Should you have any questions concerning its contents, please let us know.

Sincerely,

Debbie Davenport
Auditor General

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County Response

The County Treasurer's Office should accurately account for its cash and investment balances

The Treasurer's primary responsibility is to manage public and trust monies of the County and related public subdivisions. The Treasurer currently has been entrusted with nearly $130 million in public monies and, as a result, should maintain accurate accounting records of receipts, disbursements, and cash balances related to those monies. However, the Treasurer's procedures did not include maintaining a detailed ledger of cash on hand and investments or ensuring that receipts are recorded when received. Therefore, investments at June 30, 2001, were understated by $354,000; a $253,000 deficit of cash on hand at June 30, 2001, was recorded rather than the actual $12,000 on hand; and cash receipts collected by the Treasurer's Office on June 28 and 29, 2001, were not recorded until July 2001.

To help ensure that all the Treasurer's financial activity is accurately recorded in the accounting records, the Treasurer's Office should develop and implement policies and procedures to maintain detailed ledgers for cash on hand and investments and record receipts when collected. In addition, the Treasurer's Office should reconcile the general ledger to the detailed ledgers at least monthly and investigate and correct all reconciling differences.

The County needs to improve its property control system

Capital assets represent a major investment of County monies and should be adequately accounted for and controlled. However, the County had not established adequate internal controls to ensure that capital assets were properly recorded in the property control system. For example, the County had not deleted more than $2 million of assets that had been disposed of from its capital assets listing, did not always record construction expenditures on its listing as construction in progress, and did not reclassify $7 million of construction in progress as buildings when the projects were complete. As a result, the County overstated its capital assets. Auditors adjusted the general purpose financial statements for all significant errors noted by them.

To adequately control, safeguard, and report capital assets, the County should implement policies and procedures to prepare and maintain a complete, accurate, and up-to-date capital assets listing. These procedures should include:

- Performing a complete physical inventory of capital assets every 3 years. This should be done by an employee not responsible for the custody of or recordkeeping for capital assets.
- Removing items from the capital assets listing that have been sold, traded-in, lost, or are no longer the property of the County.
- Reconciling capitalized acquisitions to capital expenditures for all funds and correcting all errors noted.
- Reconciling the current-year capital assets listing to the prior-year listing and correcting all errors noted.
- Adding the trade-in allowance to the cost of newly acquired capital assets.
- Capitalizing equipment acquired by capital leases when the items are received and not as payments are made.
- Reclassifying construction in progress as buildings when projects are completed.

The Public Fiduciary's Office should properly account for and safeguard wards' assets

The Superior Court appoints the County's Public Fiduciary to administer the estate of individuals (wards) who are unable to handle their own affairs and to safeguard and administer their assets when no one else is willing or capable of serving in that capacity. However, the Public Fiduciary's Office did not always fulfill its obligations. The Public Fiduciary's Office did not always maintain accurate and complete inventory listings of wards' assets and did not have adequate controls to prevent wards' assets from being lost, stolen, or misplaced. For example, the Public Fiduciary's Office did not perform periodic physical inventories of wards' assets and did not change inventory listings for assets received or disposed of.

The Public Fiduciary's Office should develop and establish internal control policies and procedures, including the following procedures, to comply with statutory requirements for administering wards' assets.

- An employee who did not perform the physical inventory of a ward's assets should verify that all information on the handwritten inventory listing was correctly transferred to the typed inventory listing to be filed with the court.

- The Public Fiduciary's Office should perform physical inventories of wards' assets annually and after assets have been moved to help identify assets that have been lost or stolen.

- When releasing assets to third parties, Office employees should require the party to sign a receipt.

- Office employees should note assets acquired or disposed of on wards' inventory listings as well as in the case files. These notations should be used to reconcile the prior-year's inventory listing with the current-year's inventory listing.

- The Public Fiduciary's Office should retain all inventory listings for all wards.

In addition, County management should review control procedures periodically to help ensure that they are functioning appropriately.

The County should ensure payroll expenditures are proper and accurately recorded

Salaries, wages, and related expenditures consume a significant percentage of county resources. Consequently, payroll processing is an extremely important function that requires strong internal controls. However, the County had not established strong internal controls for the Sheriff's department. Sheriff department time sheets submitted to the Payroll department were not signed by employees and did not include hours worked each day and compensatory time earned or used. As a result, the County could not determine whether Sheriff's department employees were being paid for actual hours worked.

To adequately control payroll expenditures, the County should ensure that time sheets are submitted to the Payroll department with employee signatures and hours worked. In addition, employees should specifically identify any compensatory time earned or used on time sheets.

The County should prepare complete and accurate financial statements

The County did not accurately accumulate the financial information reported in its general purpose financial statements. As a result, many asset and liability account balances were understated. Auditors adjusted the general purpose financial statements for all significant errors noted by them.

The County should ensure that the financial information it reports to its citizens, lenders, and the federal government is accurate and complete. Therefore, the County should establish procedures to ensure that all transactions are accurately accumulated and reported in schedules supporting the financial statements so they will be recognized in the appropriate accounting period.

County management should ensure all journal entries are approved

County management should ensure that all financial transactions are properly authorized and recorded. However, the journal entries prepared by the Finance department did not always indicate, by signature, proper authorization. Therefore, there is an increased risk that incorrect journal entries may be recorded in the County's general ledger and financial statements.

To adequately control journal entries and help ensure they are proper, the employee who reviews each journal entry should sign the entry as evidence of review and approval.

September 3, 2002

Ms. Debbie Davenport, Auditor General
State of Arizona, Office of the Auditor General
2910 North 44th Street, Suite 410
Phoenix, AZ 85018

Dear Ms. Davenport:

We concur with the findings outlined in the Management Letter for the County's audit for the year ended June 30, 2001. Management has met with the elected officials and departments heads involved for each finding and corrective action is being implemented.

<u>The County Treasurer's Office should accurately account for its cash and investment balances.</u>

Actual investments exceed the amount recorded in the Treasurer's ledger. The excess referred to is an accumulation of unrecorded amounts carried forward from prior years. Distribution of this amount will be made on the direction of the County Attorney's office.

The recorded deficit of cash on hand was the result of posting errors which have now been corrected.

Receipts to the Treasurer's office in the last two days of the fiscal year will be recorded in the ledger system. New programming for that office does not allow for an early cut off.

Reconciliations are now being performed daily, whenever possible, depending on the timely receipt of necessary information from the servicing bank.

<u>The County needs to improve its property control system.</u>

In recent years the adjustments to the Fixed Asset Account Group for activities relating to prior year acquisitions have not been made. Those adjustments will be made from this point on. Such adjustments will include deletions and reclassifications.

The County is in the process of reestablishing the cycle of inventory taking to assure that every department will be inventoried every three years.

The County does have an established procedure for reconciling current year acquisitions to the additions to the fixed asset listing. That procedure will now be fully executed. Final year end listings will be reconciled to the prior year listing.

The system has been changed for the coding of lease payments and such payments will no longer be capitalized.

The Public Fiduciary's Office should properly account for and safeguard wards' assets.

The County assigned an employee to the duties of public fiduciary in 1999. Prior to that, the need for this function was either non existent or so minimal that there was no trained person in place to perform the required tasks and, therefore, there was no handing down of guidance and no period of formal training for this job.

The County will incorporate into procedures all of the suggestions outlined in the management letter for the public fiduciary role. In addition, with the start of fiscal year 2003, the County has assigned a second employee to this function so that a separation of duties will be possible.

The County should ensure payroll expenditures are proper and accurately recorded.

The County Sheriff has assigned his Commander to the project of changing the recording and reporting procedures for that department with the goal of supplying the properly authorized documentation for payroll. It is expected this documentation will provide the information that is necessary to assure valid disbursements relating to pay as well as accurate records for the valuation of compensatory time liabilities.

The County should prepare complete and accurate financial statements.

The County will include agency funds from the Treasurer's ledgers in the summaries of information used for the financial statements.

In addition, the County will slide the reporting period for the sales and the highway user revenues one month forward for the purpose of conforming this county's reporting to that of other counties in the State, as requested by your office.

County Management should ensure all journal entries are approved.

The County does have a procedure in place to obtain approval by a second party for all journal entries. Such approval is to be indicated by initials on the designated space on the journal entry form. This procedure will be enforced fully in the future.

Sincerely,

Karla F. James
Finance Director