



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Management Letter

Cochise County

Year Ended June 30, 2005



Debra K. Davenport
Auditor General

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DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

**STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL**

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

June 30, 2006

Board of Supervisors
Cochise County
1415 Melody Lane
Bisbee, AZ 85603

Members of the Board:

In planning and conducting our single audit of Cochise County for the year ended June 30, 2005, 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.

All audit findings that are required to be reported by GAS and OMB Circular A-133 have been included in the County's Single Audit Reporting Package for the year ended June 30, 2005. In addition, our audit disclosed internal control weaknesses and instances of noncompliance with laws and regulations that do not meet the reporting criteria. Management should correct these deficiencies to ensure that it fulfills its responsibility to establish and maintain adequate internal controls and comply with laws and regulations. Our recommendations are described in the accompanying summary.

In addition, as required by Arizona Revised Statutes §41-1279.21(A)(1), we reviewed the County's financial records to evaluate whether the County used Highway User Revenue Fund monies and any other dedicated state transportation monies solely for authorized transportation purposes for the year ended June 30, 2005. Our review identified an instance of noncompliance, which is described in the accompanying summary as Recommendation 1.

This letter is intended solely for the information of the Cochise 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,

Dennis L. Mattheisen, CPA
Financial Audit Director

The County should ensure that highway user and vehicle license tax monies are spent according to the Arizona Constitution and state laws

Each year, the State distributes Highway User Revenue Fund (HURF) monies and a portion of vehicle license tax (VLT) monies to the County, and the County's responsible for using these monies solely for highway and street purposes as specified in Article IX, §14 of the Arizona Constitution and Arizona Revised Statutes (A.R.S.) §§28-5801(B)(1)(c) and (2)(c), and 28-5808(A)(2)(b) and (B)(2)(b). The County received more than \$11.1 million in HURF and restricted VLT monies in fiscal year 2005. The County's Highway and Floodplain Department operates primarily from these monies, and auditors noted that the County used most of these monies to help finance highway and street construction, repairs, and maintenance. However, the County did not have written policies and procedures that clearly prescribed allowable and unallowable uses of HURF and restricted VLT monies. In addition, according to the Attorney General Opinion No. I05-003, these monies should not be used to pay liability insurance premiums. However, the County paid \$157,580 for liability insurance premiums from these monies.

The County should develop and implement written policies and procedures that clearly define the allowable and unallowable uses of HURF and restricted VLT monies and ensure that its Highway and Floodplain Department follows these policies. In addition, the County should review and approve the proposed uses of these monies to help ensure that they are spent in accordance with the Arizona Constitution and applicable state laws, including guidance provided by Attorney General Opinion No. I05-003. Finally, the County should allocate \$157,580 of local revenues for highway and street purposes to replenish the monies it spent for liability insurance premiums.

The County should improve its payroll policies and procedures

Salaries, wages, and related payroll costs are a major portion of the County's total expenses. Therefore, it is important that county employees accurately record their time spent working on various county functions or programs. Inaccurate timekeeping records could result in financial reporting and budgeting errors, as well as errors in

charging expenses to restricted grant programs. However, the County did not have policies and procedures that clearly explain how employees should record their time when they work on more than one function or program. Specifically, auditors noted that the County did not require employees to distribute their actual time worked on various functions or programs.

To help ensure that budgets and financial reports are accurate and the appropriate amount of payroll expenses are charged to restricted grant programs, the County should develop, implement, and enforce policies and procedures specifying how time worked should be recorded and allocated. The County's policies should describe how all employees are required to account for their time to ensure that payroll costs are correctly distributed to county functions and programs. To comply with federal cost principles, the policy should require employees who perform work for one or more federal programs to comply with the procedures relating to personal services described in Office of Management and Budget Circular A-87, Attachment B, §8.h.

The County should establish policies and procedures over its computer system

The County uses a computerized information system to process its financial transactions and maintain its accounting system. To help ensure that the County's computer system is operating effectively and efficiently and system data is secure, it is essential that the County have comprehensive written policies and procedures. The County has policies and procedures over most of its computer operations. However, the County still needs to establish and follow written policies and procedures for program changes and disaster recovery, including the following:

Program changes

- Maintain evidence that changes are authorized, analyzed, designed, tested, documented, and approved prior to being placed in operation.
- Obtain authorization from user management prior to implementing program changes.
- Have programmers and system operators review and approve the testing methodology.

Disaster recovery

- Identify critical computer applications and assess the risk of potential disaster exposures in the event of a major computer system or equipment failure.

- Establish a disaster recovery plan that includes the following:
 - Listing of employees assigned to disaster teams and their telephone numbers.
 - Employee assignments and responsibilities.
 - Arrangements for a designated alternate physical facility.
 - Off-site storage locations for the disaster recovery plan.
 - Procedures for testing and updating the plan on a regular basis.
 - Procedures for processing critical transactions, including forms or other documents to use.
 - Arrangements with vendors to support the needed hardware and software requirements.

A similar recommendation was previously provided in our Management Letter to the County, dated August 19, 2005.

The County should properly safeguard and report capital assets

The County has invested a significant amount of money in its capital assets. Therefore, it is essential that the County maintain effective stewardship over these assets. Effective stewardship requires the County to maintain accurate and complete listings of these assets and ensure that they are properly accounted for and accurately reported in its financial statements. However, the County did not always follow its written capital assets policies and procedures. For example, the County's policies require that a physical inventory of capital assets be performed every 2 years. Although the County completed the physical inventory counts in October 2005, it had not reconciled the physical inventory to its capital assets system, and the County had not performed a prior comprehensive inventory in at least 8 years. In addition, the County did not always prepare or retain documentation of capital assets disposals or transfers. Further, the County's policies and procedures were not updated to include procedures for recording infrastructure and did not explain how to determine the completion dates of constructed assets.

The County should ensure its capital assets are adequately safeguarded and accurately reported. To accomplish this, the County should:

- Adhere to its existing capital assets policies, including performing a physical inventory every 2 years; completing required capital assets forms for disposals or transfers; and retaining documents and required forms for 3 years after asset disposals.

- Update the capital assets policies to incorporate newly adopted accounting standards, including procedures for capitalizing and recording infrastructure.
- Establish a policy that explains how to determine the completion dates of constructed capital assets, such as buildings and improvements, to ensure that the assets are depreciated accurately and consistently.
- Distribute its capital assets policies for acceptable and unauthorized asset use to all county employees.

A similar recommendation was previously provided in our Management Letter to the County, dated August 19, 2005.

Board of Supervisors

Patrick G. Call
Chairman
District 1

Paul Newman
Vice-Chairman
District 2

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June 22, 2006

Debbie Davenport
Auditor General
State of Arizona
2910 N. 44th Street, Suite 410
Phoenix, Arizona 85018-7243

Dear. Ms. Davenport,

In response to the June 30, 2005 management letter findings and recommendations, the County has developed the following corrective actions:

State Highway User Revenues

Cochise County carefully oversees its HURF monies and will monitor to ensure that it is in compliance with the Arizona Constitution, state laws, and the current Attorney General's Opinion for usage. The use of HURF funds for liability insurance is currently under review and appeal, with Cochise County believing that this is an essential component of doing business that allows our Highway and Floodplain Department to function and is therefore an allowable expenditure. Once the issue is resolved between Arizona counties and the Attorney General, Cochise County will re-examine the issue and make adjustments as deemed necessary.

Payroll Policies and Procedures

Cochise County has developed a draft payroll/timekeeping policy and procedures, which will be taken to the Board of Supervisors for approval. It specifically addresses recordation of time when employees work on more than one program or function, compliance with Office Management and Budget Circular A-87 when employees are funded by a federal grant and a procedure to specify how payroll costs should be monitored, recorded and allocated. Periodic reviews will be made between time distribution and actual time worked.

Once the policy has been approved by the Board of Supervisors, it will be distributed to all county employees to ensure awareness of and compliance with all provisions of the payroll and timekeeping policy.

Computer System

Cochise County Information Technology department has developed draft policies and procedures for its computer system. Specifically, these include a policy for program testing and development, production software libraries modifications and development and testing libraries. A draft disaster recovery policy has also been written which specifies the disaster recovery team, an annual practical exercise of recovery, and identifies offsite storage for all tapes needed to recover file systems. A procedure has been drafted for the creation and storage of system backup tapes.

Capital Assets

Cochise County conducted a physical inventory of all capital assets in October 2005. The completed reconciliation will be entered with the conversion of our capital assets system to our New World financial system software.

The Cochise County Property Management Policy currently is under revision and when completed, will incorporate newly adopted accounting standards, including GASB 34 requirements as related to infrastructure capitalization. It will include instructions for records retention and completion date of constructed capital assets.

Once the policy has been revised and approved by the Board of supervisors, it will be distributed to all county employees to ensure awareness of and compliance with all provisions of the Property Management Policy.

Sincerely,

Lois Klein
Director of Finance