A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Management Letter

Coconino County

Year Ended June 30, 2004

State of Arizona
Office of the
Auditor General

Debra K. Davenport
Auditor General

The **Auditor General** is appointed by the Joint Legislative Audit Committee, a bipartisan committee composed of five senators and five representatives. Her mission is to provide independent and impartial information and specific recommendations to improve the operations of state and local government entities. To this end, she provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits of school districts, state agencies, and the programs they administer.

Copies of the Auditor General's reports are free.
You may request them by contacting us at:

Office of the Auditor General

2910 N. 44th Street, Suite 410 • Phoenix, AZ 85018 • (602) 553-0333

Additionally, many of our reports can be found in electronic format at:

www.azauditor.gov

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

December 30, 2005

Board of Supervisors
Coconino County
219 East Cherry Avenue
Flagstaff, AZ 86001

Members of the Board:

In planning and conducting our single audit of Coconino County for the year ended June 30, 2004, 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, 2004. 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, 2004. Our review identified certain instances of noncompliance, which are described in the accompanying summary as Recommendation 1.

This letter is intended solely for the information of the Coconino 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

TABLE OF CONTENTS

Recommendation 1: The County should ensure that state highway user revenues are spent according to state laws 1

Recommendation 2: The Treasurer's Office should ensure that responsibilities are properly separated 1

Recommendation 3: The County's financial reporting system should provide complete and accurate information for federal reporting 2

County Response

The County should ensure that state highway user revenues are spent according to state laws

Each year, the State distributes Highway User Revenue Fund (HURF) monies and a portion of the vehicle license tax (VLT) monies to the County and mandates that the County use these monies solely for highway and street purposes. During the fiscal year, the County Highway Department received almost $12.2 million in HURF and restricted VLT monies, more than 68 percent of the Public Works Fund revenues. Although the Department used most of these monies to help finance highway and street construction, repairs, and maintenance, and to pay principal and interest on transportation bonds, it also used them to pay costs that were not for highway and street purposes. Auditors noted that the County Highway Department spent over $160,000 of HURF and restricted VLT monies to finance unallowable costs, such as liability insurance premiums and uninsured losses.

To help ensure that HURF and restricted VLT monies are used only for street and highway purposes in accordance with the Arizona Constitution, Article 9, §14, the County should:

- Work with the county attorney to develop a policy regarding the types of expenditures that are appropriate uses of HURF and restricted VLT monies.
- Provide the policy to the County Highway Department officials who are responsible for approving Public Works Fund expenditures.
- Reimburse the Public Works Fund for $160,000 spent inappropriately for liability insurance premiums and uninsured losses with revenue from its General Fund or other unrestricted revenue sources.

The Treasurer's Office should ensure that responsibilities are properly separated

The primary responsibility of the County Treasurer's Office is to manage public and trust monies of the County and related public subdivisions. At June 30, 2004, the Treasurer's Office was entrusted with over $168 million in public monies. To fulfill the responsibilities of managing these monies, the Treasurer's Office should ensure that internal controls are in place and functioning properly to promote overall operational efficiency and effectiveness, compliance with laws and regulations, and reliable financial reporting. However, the Treasurer's Office did not ensure that employee responsibilities were separated so that no single employee had control over an entire transaction cycle. Incompatible duties were being performed for the cash receipts and investments transaction cycles.

To help ensure that the Treasurer's Office adequately safeguards cash and investments, the County should separate responsibilities between employees so that the employees with access to cash receipts are not responsible for recording and depositing the receipts. In addition, a supervisor should review the daily reconciliations. Further, the County should separate investment responsibilities so that the same employee does not initiate and approve investment transactions, or monitor investment performance. If the responsibilities cannot be adequately separated because of the small staff size, then a supervisor should review and approve the transactions and related reconciliations.

The County's financial reporting system should provide complete and accurate information for federal reporting

The County is required by the Office of Management and Budget (OMB) Circular A-133 to prepare a Schedule of Expenditures of Federal Awards (SEFA). However, the County's financial reporting system did not provide sufficient detailed information to comply with federal requirements. Specifically, the financial reporting system did not separately identify federal, state, and local expenditures charged to each federal program. In addition, the County did not always record federal revenues and expenditures in the appropriate accounts that resulted in a $280,000 misstatement in the SEFA. Also, expenditures for different federal programs were recorded in the same funds and were not separately identified by federal program. Further, numerous program titles and identification numbers reported on the SEFA were incorrect. The County adjusted the SEFA for all significant errors noted by the auditors.

The County must comply with the federal reporting requirements of OMB Circular A-133 §§.300(a) and .310(b). To accomplish this, the County should clearly identify in its accounts for each federal program the name of the federal program, name of awarding federal agency and pass-through entity, CFDA number, and amount of federal award expenditures during the period. In addition, for programs that include both federal and other funding sources, the County should separately identify in its accounting records expenditures of program monies by funding source. Also, the County should have a second employee review the SEFA to ensure the accuracy of program titles, identification numbers, and amounts.

COCONINO COUNTY ARIZONA

FINANCE DEPARTMENT

Michael F. Townsend
Director

December 20, 2005

Debbie Davenport
Auditor General
2910 N. 44th Street, Suite 410
Phoenix, AZ. 85018

Dear Ms. Davenport,

Coconino County has chosen to respond to the Management Letter for the fiscal year ended June 30, 2004. Our responses to the Management Letter are below.

Recommendation 1: The County should ensure that state highway user revenues are spent according to state laws.
Response: The County will comply with the auditor general's recommendations.

Recommendation 2: The Treasurer's Office should ensure that responsibilities are properly separated.
Response: The Treasurer's office now has internal controls in place and functioning properly to promote overall operational efficiency and effectiveness, compliance with laws and regulations, and reliable financial reporting, including separation of duties.

Recommendation 3: The County needs to ensure its financial reporting system provides complete and accurate information for federal reporting

Response: The County is unable to include all of the information recommended in its accounts. The County currently identifies federal revenue in its accounts and in most cases uses a separate fund for each funding source. In the future if a fund includes multiple funding sources federal expenditures will either be identified by account or all expenditures of the fund will meet the funding source requirements. The SEFA is currently reviewed by second employee. The County has changed it's procedures for compiling all of the information for the SEFA to ensure accuracy.

Sincerely,

Michael Townsend
Finance Director

219 East Cherry Avenue • Flagstaff, AZ 86001-4695
928-779-6677 • Fax 928-779-6893