A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Procedural Review

Arizona Department of Financial Institutions

As of February 28, 2013

STATE OF ARIZONA
OFFICE OF THE
AUDITOR
GENERAL

Debra K. Davenport
Auditor General

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STATE OF ARIZONA

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

OFFICE OF THE
AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

July 17, 2013

Lauren W. Kingry, Superintendent of Financial Institutions
Arizona Department of Financial Institutions

We have performed a procedural review of the Department's internal controls in effect for the period July 1, 2012 through February 28, 2013. Our review consisted primarily of inquiries, observations, and selected tests of internal control policies and procedures, accounting records, and related documents. The review was more limited than would be necessary to give an opinion on internal controls. Accordingly, we do not express an opinion on the effectiveness of internal controls or ensure that all deficiencies in internal controls are disclosed.

Specifically, we reviewed cash receipts, cash disbursements, purchasing, payroll, journal entries, transfers, and capital assets.

As a result of our review, we noted certain deficiencies in internal controls that the Department's management should correct to ensure that it fulfills its responsibility to establish and maintain adequate internal controls. Our findings and recommendations concerning these deficiencies are described in the accompanying summary.

The Office of the Auditor General is also conducting a performance audit and sunset review of the Arizona Department of Financial Institutions. The results of that audit will be issued at a future date.

This report is intended solely for the information and use of the Department and is not intended to be and should not be used by anyone other than the specified party. However, this report is a matter of public record, and its distribution is not limited.

Should you have any questions concerning our procedural review, please let us know.

Sincerely,

Jay Zsorey, CPA
Financial Audit Director

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concluded

FINDING 1

The Department should strengthen its controls over cash receipts

The Department receives a significant portion of its operating revenues from licensing and regulating state-chartered financial institutions and enterprises in the form of licensing application fees, renewal fees, assessments, and fines. During our review period of July 1, 2012 through February 28, 2013, the Department recorded approximately $7.9 million in revenues in the form of cash and checks. Because cash receipts are susceptible to loss or theft, it is imperative that the Department adequately control and safeguard these monies. Further, the State of Arizona Accounting Manual, Sections II-C-1 and II-Q, requires all state agencies to separate cash receipt and recordkeeping responsibilities, safeguard receipts prior to deposit, and have two employees present when the mail is opened and resulting receipts are recorded. However, auditors determined that the Department did not follow these procedures.

Internal Control Deficiencies Over Department Receipt Collections

Our review of the Department's procedures for collecting, recording, and processing cash receipts found that cash receipt responsibilities were not adequately separated since the licensing staff were responsible for collecting receipts and the recordkeeping functions. We also found that mail receipts were not opened and recorded in the presence of two employees. Further, although cash was immediately stored in the safe by department personnel, checks were stored in an unsecure bin prior to being placed in the safe.

Recommendations

To help strengthen controls over cash receipts, help ensure department receipts are properly recorded and deposited, and to comply with the State of Arizona Accounting Manual, the Department should:

1. Separate cash receipts responsibilities to ensure that one employee collects receipts and a different employee records receipts in the accounting records.

2. Require two employees to open the mail and record mail receipts.

3. Require checks received to be locked in a safe prior to deposit.

FINDING 2

The Department should maintain accurate capital asset records

Effective stewardship over capital assets requires the Department to perform an annual physical inventory of its capital assets, such as computers and other equipment valued at $5,000 or more. Also, the State of Arizona Accounting Manual, Section II-G-1, requires each agency to conduct an annual physical inventory of all capital assets and update the State's Fixed Asset System (FAS) for all additions, deletions, or corrections as a result of the physical inventory. Further, agencies are required to maintain supporting documentation for all disposals of capital assets, and to update the FAS within 5 working days of the disposal date. However, auditors determined that the Department had not performed an annual physical inventory of its capital assets for approximately 6 years. Auditors also found that the Department did not always maintain capital asset disposal documentation or remove disposed assets from the FAS system. As a result, the State's General Accounting Office did not have accurate information regarding the Department's capital assets when preparing the State's annual financial statements.

Recommendations

To help ensure that the Department's capital assets are adequately controlled and to help ensure the accuracy of the State's capital assets listing and financial statements, the Department should conduct a complete physical inventory of all capital assets at least annually and update the FAS for any corrections needed based on the results of the inventory. The Department should also maintain all supporting documentation for capital asset disposals and update the FAS system within 5 working days of the disposal date.

ARIZONA DEPARTMENT OF FINANCIAL INSTITUTIONS

Lauren W. Kingry
Superintendent of Financial Institutions

Janice K. Brewer
Governor

June 28, 2013

Jay Zsorey, CPA
Financial Audit Director
Office of the Auditor General
2910 N. 44th St., Suite 410
Phoenix, AZ 85018

Dear Mr. Zsorey:

The Department of Financial Institutions appreciates the opportunity to respond to the findings of the procedural review performed by your office as of February 28, 2013. We would also like to express our appreciation to your staff for their professionalism and efficiency while conducting the review.

Internal Controls Over Cash Receipts

Finding 1: Cash receipt responsibilities were not adequately separated since the licensing staff were responsible for collecting receipts and the recordkeeping function.

> Response: While the use of prenumbered receipts mitigates the risk posed by this deficiency, a new business process - that separates responsibilities - will be established by the Department when it converts to a new licensing system in the near future. Funding for a new electronic licensing system has already been set aside for this purpose and will be available for the Department to use in FY 2014.

Finding 2: Mail receipts were not opened and recorded in the presence of two employees.

> Response: Given the agency's small staff size, resources have not historically been available to allow for the opening and receipting of mail by two employees. The potential risk created by this deficiency is mitigated by the fact that 1) the mail clerk does not have access rights to update records in the Department's licensing system and 2) the Department uses prenumbered receipts to record all collections. Having said that, the Department will review its current business process and, if possible and practical, implement procedures that will require two employees to be present when opening mail and recording receipts.

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Finding 3: Although cash was immediately stored in the safe by department personnel, checks were stored in an unsecure bin prior to being placed in the safe.

> Response: All checks received by the Department are immediately endorsed with the Department's stamp, mitigating the risk of loss. However, in the future, all checks received at the Licensing counter will be immediately secured in a locked box or cabinet.

Internal Controls Over Capital Assets

Finding 1: The Department has not performed an annual physical inventory of its capital assets for approximately 6 years.

> Response: The Department conducted a physical inventory of its capital assets as of June 28, 2013 and found that a number of previously disposed assets had not been removed from the FAS system. Those assets, which Department records indicate had previously been sent to Surplus Property, have now been removed from the system. Going forward, a physical inventory will be conducted annually.

Finding 2: The Department did not always maintain capital asset disposal documentation or remove disposed assets from the FAS system

> Response: Procedures are now in place to ensure that disposal documentation is always maintained and disposed assets are removed from the FAS system timely.

The Department recognizes the importance of maintaining a strong system of internal controls and will make the necessary improvements to address the deficiencies noted in the report.

Sincerely,

Lauren W. Kingry
Superintendent of Financial Institutions

cc: Michael Fowler, Administration Division Manager

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