A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Management Letter

Industrial Commission of Arizona

Year Ended June 30, 2002

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.

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

March 14, 2003

Larry Etchechury, Director
Industrial Commission of Arizona
800 West Washington Street
Phoenix, AZ 85007

Dear Mr. Etchechury:

In planning and conducting our audit of the State of Arizona for the year ended June 30, 2002, we considered the Commission's internal controls over financial reporting and tested its compliance with laws and regulations that could have a direct and material effect on the State's financial statements as required by *Government Auditing Standards*.

Specifically, we performed tests of journal entries; bidding; cash; investments, including security lending transactions; receivables; capital assets; accrued insurance losses; revenues; expenses; related party transactions; and financial reporting of the Commission's special fund.

There are no audit findings that are required to be reported by *Government Auditing Standards*. However, our audit disclosed internal control weaknesses 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. Our recommendation is briefly described below.

The Commission Should Develop Written Policies and Procedures for Its Accounting and Management Information System (MIS) Operations

Written policies and procedures provide the basic framework needed for establishing employee accountability. They serve as a reference tool for employees seeking guidance on how to handle complex or infrequent transactions and situations. Additionally, they offer guidance for controlling daily operations. Reliance on appropriate written policies and procedures can reduce the risk of errors and fraud, and helps ensure accuracy and continuity in processing transactions. However, the Commission lacked detailed written policies and procedures. The Commission should identify its significant accounting and MIS operations and develop written policies and control procedures that address the following responsibilities:

Accounting Operations—
- Separating responsibilities—to ensure that no one person controls both recordkeeping and transaction processing activities
- Authorizing transactions—to ensure that responsible personnel approve all transactions
- Maintaining accounting records—to ensure that all transactions are valid and recorded accurately and in a timely manner, and to ensure that no valid transactions have been omitted from the accounting records
- Maintaining physical control over assets and accounting records—to ensure that access to physical assets and information are controlled and properly restricted to authorized personnel
- Resolving errors—to ensure that errors detected at any stage of processing receive prompt corrective action and are reported to the appropriate level of management
- Monitoring—to ensure that internal control procedures are placed into operation and continue to operate effectively

MIS Operations—
- Operating the computer—to ensure that programs are used properly and that only the proper data files are used during processing
- Making changes to computer programs—to ensure program changes are approved, designed, tested, and implemented
- Establishing computer backup and recovery—to ensure critical functions continue in emergency situations
- Accessing programs and data—to ensure that authorized access is granted to programs and data as well as physical access

This letter is intended solely for the information of the Commission, 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 Industrial Commission Of Arizona

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LARRY ETCHECHURY, DIRECTOR
TERESA HILTON, SECRETARY

March 6, 2003

Debra K. Davenport
Auditor General
Office of the Auditor General
2910 N. 44th Street, Suite 410
Phoenix, AZ 85018

Dear Ms. Davenport:

In response to the items found in the auditor's management letter pertaining to the accounting operations and the MIS operations dealing with written policies and procedures is provided in the following:

Accounting Operations

The Special Fund Accounting Supervisor and the three Special Fund Accounting Technicians all have procedure manuals to ensure their work is performed correctly pertaining to their positions. These manuals do need to be updated as tasks have changed since they were first written and do not explain any internal controls at all. The Industrial Commission does plan to update these procedure manuals. The commission also needs to complete a procedure manual for the Special Fund Accountant, as there is not one at the present time. We are planning to start the manual for this position in the next few months.

The procedure manuals are living documents, which must periodically be updated due to changing needs and conditions of the work environment. The procedure manuals will discuss issues dealing with internal controls such as separation of duties when workforce size allows, authorization of transactions, maintaining accounting records, maintaining physical control over assets and accounting records, the proper resolution of errors, and proper monitoring of the internal control system.

MIS Operations

A MIS Operation manual will be produced which will explain control procedures along with the following listed areas on the Auditor General's Management letter:

Operating the Computer –

The batch processing jobs for the Special Fund accounting system are programmed as scripted well-defined processes. Strict control is in place so that only MIS staff has access to them and MIS staff only can execute them. They are totally restricted from any end users access.

Program Change Controls –

I have defined and implement a "Change" management procedure and documentation form that address these points. The form is attached to this memo for your review.

We have also implemented the use of an automated library control software program called Microsoft SourceSafe that will manage source and object programs of the system. This program records who and when a given program was checked out of the "safe", when it was checked back in and what changes were made to a given program.

Backup and Recovery –

Currently, the Special Fund accounting system runs on a dedicated UNIX server, warrants and reports are generated on a line printer and laser printer respectively. The data and system software is backed-up every night and sent off site to archives. In the case of a disaster, manual accounting procedures would be the fail back option available until the hardware/software could be replaced and the system recovered.

Accessing programs and data –

Physical access to the ICA Operations Center is strictly controlled. Only the MIS staff, building maintenance and security staffs have access into the Operations Center via electronic badge readers. These readers maintain a log of who entered by date and time.

Sincerely,

Glenn M. Hurd
Manager, Accounting Division

Attachment

GH:sc