A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Report on Internal Control and Compliance

Maricopa County

Year Ended June 30, 2015

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.

INTEGRITY ★ ACCOUNTABILITY ★ MAKING A DIFFERENCE

The Auditor General's reports are available at:

www.azauditor.gov

Printed copies of our reports may be requested by contacting us at:

Office of the Auditor General

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

Maricopa County
Report on Internal Control and Compliance
Year Ended June 30, 2015

Table of Contents

Report Issued Separately

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Basic Financial Statements Performed in Accordance with *Government Auditing Standards*

Members of the Arizona State Legislature

The Board of Supervisors of
Maricopa County, Arizona

We have audited, in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the governmental activities, business-type activities, discretely presented component unit, each major fund, and aggregate remaining fund information of Maricopa County as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the County's basic financial statements, and have issued our report thereon dated December 21, 2015. Our report includes a reference to other auditors who audited the financial statements of the Stadium District, Risk Management, Employee Benefits Trust, Housing Authority, and Industrial Development Authority, as described in our report on the County's financial statements. This report includes our consideration of the results of the other auditors' testing of internal control over financial reporting and compliance and other matters that are reported on separately by those other auditors. However, this report, insofar as it relates to the results of the other auditors, is based solely on the reports of the other auditors.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the County's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control. Accordingly, we do not express an opinion on the effectiveness of the County's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Recommendations, we and the other auditors identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the County's basic financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Recommendations as items 2015-01 and 2015-02 to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings and Recommendations as items 2015-03, 2015-04, and 2015-05 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the County's basic financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests and those of the other auditors disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Maricopa County Response to Findings

The County's responses to the findings identified in our audit are presented on pages 7 through 9. The County's responses were not subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the County's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the County's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Jay Zsorey, CPA
Financial Audit Director

December 21, 2015

Financial Statement Findings

2015-01

The County should follow its policies and procedures when preparing financial statements and note disclosures

Criteria: The County's Governing Board and management depend on accurate information to fulfill their oversight responsibilities and to report accurate information to the public and agencies from which the County receives funding. Accordingly, the County should follow its policies and procedures over financial statement preparation to ensure its financial statements are accurate and complete and prepared in accordance with generally accepted accounting principles (GAAP).

Condition and context: The County's Department of Finance did not consistently follow GAAP when preparing its financial statements, note disclosures, and Required Supplementary Information (RSI). Specifically, auditors noted that the County did not:

- Properly report the net pension liability, and certain revenue and expenses related to pensions in its financial statements, note disclosures, and RSI. For example, the County under-reported pension revenues and expenses by $17 million in its financial statements and did not disclose in its notes $57.5 million for the Elected Officials Retirement Plan (EORP) because the County did not account for state funding related to the pension plan. In addition, the County understated its pension liability and expenses by $4.5 million because it excluded the pension amounts related to one of its departments. Further, the pension note disclosures and RSI contained numerous errors. For instance, summary information for the deferred outflows of resources in the pension disclosures were understated because the County's current year pension contributions were excluded.
- Reconcile and accurately report fiduciary cash and investments held by the County Treasurer in the financial statements and related note disclosures. Investments reported in the Statement of Fiduciary Net Position were overstated by $48 million for the investment trust funds and $111 million was misclassified between the investment trust and agency funds.
- Report $18.5 million in accounts payable in the County Improvement Capital Projects fund. These payables were incorrectly reported in four separate governmental funds.
- Properly report $34 million of capital assets in the capital assets note disclosure. These assets were attributable to a flood control project that was completed in a prior year, but were reported as construction in progress. The completed project should have been classified as infrastructure and depreciated.
- Accurately report contractual commitments in its note disclosures for commitments. Contractual commitments were overstated by $18 million in the disclosure.
- Record $2.9 million in inventory in the correct governmental fund on the balance sheet.

Effect: The County's financial statements, note disclosures, and RSI were not prepared in accordance with GAAP. The County made recommended audit adjustments to the financial statements, note disclosures, and RSI for all significant errors and omissions.

Cause: The County did not accurately compile and thoroughly review the financial statements, note disclosures, schedules, and other information supporting the financial statements.

Recommendation: To help ensure accuracy of the County's financial statements, the County should follow GAAP and its policies and procedures for compiling its financial statements, note disclosures, and schedules. In addition, the County should improve its procedures by requiring a more detailed review of all data and schedules supporting the financial statements, note disclosures, and RSI.

This finding is similar to prior-year finding 2014-01.

2015-02

The County should improve access controls over its information technology resources

Criteria: The County Treasurer's Office should have effective internal control policies and procedures to control access to the Treasurer's information technology (IT) resources, which includes its systems, network, infrastructure, and data.

Condition and context: The Treasurer's Office did not have adequate policies and procedures in place to limit logical access to its IT resources. Specifically, auditors found that for 5 of 17 employees' access tested, the Treasurer's Office did not maintain documentation authorizing the access granted and access rights had not been properly updated to account for changes in job responsibilities, resulting in inappropriate system access. In addition, for another employee, internal controls were circumvented by allowing access to the Treasurer's IT resources before approving the employees' access. Further, the Treasurer's IT access request forms were not sufficient to document access granted to employees was compatible with their job responsibilities.

Effect: There is an increased risk that the Treasurer's Office may not prevent or detect unauthorized access or use, manipulation, damage, or loss of its IT systems, including sensitive and confidential information.

Cause: During the fiscal year, the County established new policies and procedures over access to its IT resources, including updates to IT access request forms and verifications of current system access rights. However, the updated forms were not sufficient to verify the access granted for the users was appropriate.

Recommendation: To help prevent and detect unauthorized access or use, manipulation, damage, or loss to the Treasurer's IT resources, its policies and procedures should include the following:

- Performing a periodic, comprehensive review of all existing employee access accounts to ensure that network and system access granted is needed and compatible with job responsibilities.
- Reviewing employees' network and systems access immediately when their job responsibilities change to ensure access granted is compatible with their new job responsibilities.
- Only granting access to its network and systems after appropriate approval is obtained.

2015-03

The County should monitor controls over its outside service organizations

Criteria: The Treasurer's Office should have policies and procedures in place to obtain and review audits of its outside service organizations. Independent audits are an effective way to determine if transactions being processed by the outside service organization are accurate and complete and confidential data is being properly safeguarded.

Condition and context: The Treasurer's Office used two outside service organizations to collect electronic property tax payments and relies on the organizations' internal controls to ensure that its property taxes are processed accurately and records are properly safeguarded. The service organizations had independent audits performed over internal controls to help demonstrate that the internal controls were operating effectively; however, the Treasurer's Office did not obtain or review these audit reports. The Treasurer's Office subsequently obtained and reviewed the audit reports after the auditors brought it to their attention.

Effect: There is a risk that the outside service organizations do not have adequate internal controls in place to appropriately collect the property taxes, which could lead to fraud, theft, manipulation, or misuse of monies.

Cause: The Treasurer's Office did not have policies and procedures in place to ensure the outside service organizations' independent audit reports were obtained and reviewed.

Recommendation: The Treasurer's Office should establish internal control policies and procedures to obtain and review its outside service organizations' independent audit reports and require corrective action by the service organization for any internal control deficiencies reported that would affect property tax collections.

2015-04

The County should maintain documentation of its calculation of indirect cost expenditures

Criteria: The County should follow its policies and procedures and maintain supporting documentation for calculation of indirect cost expenditures. In addition, indirect cost expenditure transactions should be reviewed and approved.

Condition and context: The Maricopa County Education Service Agency (MCESA) did not follow the County's policy to maintain documentation for expenditures, which include the calculation of indirect cost expenditure transactions. Specifically, for 1 of 60 nonpayroll expenditure transactions tested, MCESA did not maintain documentation to support its calculation of an indirect cost expenditure for a federal program. MCESA attempted to recreate the calculation to support the expenditure, and auditors noted the allowable indirect cost expenditure reimbursements for the fiscal year appeared reasonable. The deficiency appears to be isolated to MCESA's indirect cost expenditures.

Effect: There is a risk of fraud, theft, and abuse if expenditures are not properly supported, reviewed, and approved.

Cause: MCESA did not maintain documentation to support the calculation of indirect costs for one of its federal programs.

Recommendation: MCESA should follow the County's policies and procedures to maintain supporting documentation for expenditures that would include the calculation of indirect cost expenditures. In addition, the calculation of indirect cost expenditures should be reviewed and approved to ensure the calculations are proper.

Other auditors' findings:

The other auditors who audited the Housing Authority reported the following significant deficiency:

2015-05

General Ledger Maintenance

Condition: Financial information relating to certain balance sheet accounts and inter-program transactions were not recorded appropriately and/or reconciled on a timely basis.

Criteria: Adequate internal controls require accurate recording and periodic reconciliation of general ledger activity to ensure accurate financial reporting.

Cause: Significant employee turnover in the finance department.

Effect or potential effect: Additional year-end reconciliations and adjustments were necessary.

Recommendation: We recommend that financial activity for all balance sheet accounts be reconciled on a periodic basis to ensure accurate timely financial reporting.

COUNTY RESPONSE

Maricopa County
Department of Finance

Shelby L. Scharbach
CPA, CGFM
Assistant County
Manager and
Chief Financial Officer
301 West Jefferson Street
Suite 960
Phoenix, AZ 85003-2143
Phone: 602.506-3561
Fax: 602.506-4451
www.maricopa.gov/finance

February 9, 2016

Ms. Debbie Davenport
Auditor General
2910 North 44th Street, Suite 410
Phoenix, Arizona 85018

Dear Ms. Davenport,

The accompanying Corrective Action Plan has been prepared as required by Governmental Auditing Standards. Specifically, we are providing you with the name of the contact person responsible for the corrective action, the corrective action planned, and the anticipated completion date for the finding included in the Report on Internal Control and Compliance.

Sincerely,

Shelby L. Scharbach, CPA, CGFM
Assistant County Manager - Chief Financial Officer

2015-01
The County should follow its policies and procedures when preparing financial statements and note disclosures
Contact person: John Lewis, Deputy Director, Department of Finance, (602) 506-1373
Anticipated Completion Date: June 2016

Concur. The items related to the pension disclosures were a result of the implementation of GASB 68, which was extremely intricate and complicated to implement. The errors related to investment trust and agency funds primarily resulted from previously issued guidance to classify funds a certain way, in addition to an error relating to the overstatement amount. The remaining errors were due to oversight. Although, the Department of Finance performs multi-level detailed reviews on all financial statements, note disclosures and required supplementary information, errors can occur due to the complex nature of the disclosures and manner in which analysis is performed. All items were corrected prior to issuance of the financial statements.

2015-02
The County should improve access controls over its information technology resources
Contact person: Phil Van Kley, Information Systems Manager, Maricopa County Treasurer, (602) 506-4635
Anticipated Completion Date: Completed December 2015

Concur. The first issue pertaining to 5 of 17 employees with inadequate documentation has been corrected. The Treasurer had recently revamped the access control documentation and that change did not document users that had multiple login ID's authorized. This shortcoming has been addressed and these unique authorized situations are now properly captured in the documentation. The second issue pertained to how access was granted to a new employee prior to completion of the formal documentation. We do not believe that the IT systems were at risk to unauthorized use, manipulation, damage, or loss, as the employee's manager authorized the access. This instance was an isolated incident in which extenuating circumstances prevented the formal completion of the paperwork prior to management approval of access.

2015-03
The County should monitor controls over its outside service organization
Contact person: Richard Challoner, Banking Services Manager, Maricopa County Treasurer, (602) 506-3413
Anticipated Completion Date: Completed December 2015

Concur. Each December, the Cashiering and Client Services Director will initiate a request with all external vendors (Chase Bank and Official Payments) that they provide their organization's independent audit reports. Any control deficiencies will be addressed and require immediate corrective action. Supplying independent audit reports has also been addressed in the servicing contracts held between the Treasurer's Office and the two outside organizations mentioned above.

2015-04
The County should maintain documentation of its calculation of indirect cost expenditures
Contact person: Marc Kuffner, Assistant Superintendent for Economic Management, Maricopa County Education Service Agency, (602) 506-2068
Anticipated Completion Date: Completed July 2015

Concur. Beginning in Fiscal Year 2016, MCESA has since implemented the process that will no longer claim portions of the indirect costs and will only claim indirect costs based on the monthly report(s) where the transactions and amounts are validated. In addition, two individuals approve the documentation with signatures, in addition to the system approvals, to ensure proper management of the program costs and indirect cost reimbursements.

Responses to other auditors' findings:

2015-05
Housing Authority of Maricopa County (HAMC): General Ledger Maintenance
Contact person: Mario L. Aniles, HAMC Finance Director, (602) 744-4517
Anticipated Completion Date: Completed December 2015

Concur. HAMC has fully implemented a review and reconciliation of all balance sheet accounts on a monthly basis.

INTEGRITY ★ ACCOUNTABILITY ★ MAKING A DIFFERENCE

Maricopa County
Report on Internal Control and Compliance
Year Ended June 30, 2015

State of Arizona
Office of the Auditor General