A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Report on Internal Control and Compliance

Maricopa County

Year Ended June 30, 2010

STATE OF ARIZONA
OFFICE OF THE
AUDITOR
GENERAL

Debra K. Davenport
Auditor General

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Maricopa County
Report on Internal Control and Compliance
Year Ended June 30, 2010

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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 the financial statements of the governmental 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, 2010, which collectively comprise the County's basic financial statements, and have issued our report thereon dated December 20, 2010. Our report was modified to include a reference to our reliance on other auditors. We conducted our audit 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. Other auditors audited the financial statements of the Stadium District, Risk Management, Employee Benefits Trust, and the Housing Authority of Maricopa County, 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, we considered the County's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the County's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Recommendations, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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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 10-01, 10-03, and 10-04 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 item 10-02 described in the accompanying Schedule of Findings and Recommendations to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the County's basic financial statements are free of 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 disclosed an instance of noncompliance that is required to be reported under *Government Auditing Standards*, and which is described in the accompanying Schedule of Findings and Recommendations as item 10-04.

Maricopa County's responses to the findings identified in our audit are presented on pages 7 through 9. We did not audit the County's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the members of the Arizona State Legislature, the Board of Supervisors, management, others within the County, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record, and its distribution is not limited.

Jay Zsorey, CPA
Financial Audit Director

December 20, 2010

10-01
The County should improve capital asset reporting

Criteria: The County should accurately account for and value its capital assets in the government-wide financial statements as required by Governmental Accounting Standards (GASB) No. 34, *Basic Financial Statements—Management's Discussion and Analysis—for State and Local Governments.*

Condition and context: Approximately $3 billion, 63 percent of the County's total assets, consists of capital assets. Of this amount, approximately $1.5 billion is composed of general capital assets, $1 billion of transportation assets, and $0.5 billion of flood control assets. During test work on the County's capital assets, auditors noted the following errors:

- The County did not remove land of $2 million, infrastructure of $20.4 million, and construction in progress of $1 million for its transportation assets. Most of these assets had been disposed of by the County prior to July 1, 2009.

- The County did not record general county assets of $4 million in land and $1.9 million in buildings, net of accumulated depreciation, of which the majority were conveyed to the County prior to July 1, 2009.

- The County incorrectly capitalized $4.5 million of transportation construction in progress for projects the County discontinued, projects that were completed, or for costs that were related to other government's construction projects. In addition, the County incorrectly capitalized $0.6 million of transportation infrastructure assets that were annexed by cities and towns prior to June 1, 2009. The County did not adjust its financial statements for these errors.

Effect: The County restated its July 1, 2009 beginning balances by $17.5 million to correct for significant prior year errors related to its transportation assets and general capital assets; however its transportation assets were still overstated by $5.1 million. This finding is a material weakness in internal control over financial reporting.

Cause: While the County did make some improvements to its internal controls for recording and reporting transportation assets during the year, it did not consistently apply its draft policies and procedures throughout the fiscal year, which led to these errors. The errors with general capital assets were due to oversight in prior years and were discovered by the County when updating its capital asset listing during the current year.

Recommendation: The County should consistently apply its policies and procedures to accurately account for and value its capital assets. In addition, the County should ensure these policies and procedures include, but are not limited to, the following:

- Expense costs for projects in the period that the project is discontinued;
- Establish guidelines to determine when to capitalize costs associated with projects managed in conjunction with other governments;

- Allocate to the appropriate asset category construction in progress costs for completed projects;
- For infrastructure assets annexed by cities and towns, remove the historical value of infrastructure assets from the County's accounting records in the fiscal year in which the annexation ordinance is received; and
- Record and report the historical cost of conveyed assets in the fiscal year that the assets are received.

This finding is similar to a prior-year finding.

10-02

The County should investigate and resolve unreconciled differences for cash and investments between the Finance Department's and County Treasurer's records

Criteria: Cash and investments should be accurately reported on the County's financial statements and corresponding notes to financial statements. To help ensure accuracy, the County should reconcile the cash and investment balances to the Treasurer's Office annual report, and investigate and resolve all differences.

Condition and context: The County Treasurer had approximately $3.7 billion of cash and investments at June 30, 2010. The County reconciled cash and investments recorded in the Treasurer's accounting system to the amounts reported on the financial statements; however, auditors noted that the County had an unresolved difference of approximately $34.6 million. After investigating the differences, the County was able to identify all but $3.9 million of the difference.

Effect: The County overstated its current year contributions from participants by $12.4 million and overstated beginning net assets by $26.1 million, for a total overstatement of $38.5 million in cash and investments in the Investment Trust Fund. As a result, the County overstated its U.S. agency securities in the notes to financial statements by $38.5 million. The County adjusted the financial statements and accompanying notes for these errors. However, cash and investments and contributions from participants in the Investment Trust Fund, and U.S. agency securities presented in the notes to financial statements are still potentially understated by approximately $3.9 million. This finding is a significant deficiency in internal control over financial reporting.

Cause: Most of the misstatement was caused by an adjustment that was posted twice because of human error. The County was investigating the remaining difference of $3.9 million, but was unable to determine the reason for the difference by the report date.

Recommendation: The County should investigate and resolve all differences between cash and investments between the Finance Department's and County Treasurer's records on a timely basis.

10-03
The County should strengthen logical access controls for its computer systems

Criteria: Logical access controls ensure that only authorized users have access to the County's computer systems and are necessary to protect computer systems and data from unauthorized use, damage, loss, modification, or disclosure. To comply with industry standards, employees should have access to only those applications necessary for their job responsibilities. When circumstances exist that require an employee to have heightened access privileges, a supervisor should review the employee's system activity.

Condition and context: Auditors examined user access rights within the County's document storage system and general ledger system. While testing controls, auditors identified the following instances of incompatible responsibilities:

- Two employees had unlimited access privileges within the general ledger system and heightened access privileges within the document storage system. The employees' activities within the systems were not adequately monitored.

- Eight accounts-payable employees had incompatible responsibilities and had the ability to create, modify, and approve payment vouchers in the general ledger system. Two of these employees also had the ability to create, modify, and approve payment vouchers in the document storage system. No supervisory review of the employees' activities was performed.

- The two employees with unlimited access privileges and the eight accounts payable employees with incompatible responsibilities had the ability to create new vendors in the system and approve payment vouchers. Specifically, anyone can register a vendor online through the Maricopa County's website and the information is uploaded directly into the vendor module of the general ledger system. Once the information was in the system, payments could be made to the vendor.

- One finance department employee had the ability to create, modify, and approve journal entries in the general ledger system. No supervisory review of the employee's activities was performed.

Effect: Employees may have access to unauthorized information and the ability to perform unauthorized functions, including creating and approving vendors, purchase requisitions, receiving documents, payment vouchers, and journal entries. Specifically, this could potentially allow an employee with unlimited access privileges or one of the accounts payable employees to create a vendor and make a fraudulent payment without detection which could possibly misstate the financial statements. This finding is a material weakness in internal control over financial reporting.

Cause: The County believed it had adequate compensating controls in place to ensure that material risks were mitigated. Further, the accounts payable employees were given incompatible approval access to expedite the approval process in the event of a processing error.

Recommendation: The County should have control procedures in place to ensure users are not granted incompatible access rights, as follows:

- For users with unlimited access, the County should track critical activities on the system and an independent reviewer should monitor and review the activities regularly.
- Accounts-payable employees should only have the authority to make a final approval on payment vouchers and should not be able to create or modify payment vouchers. If any errors are noted while processing a payment voucher, the affected department should be responsible for correcting the error.
- The County should perform a review of employees with multiple user names within the system to ensure that the employees do not have incompatible access rights.

This finding is similar to a prior-year finding.

10-04
The County should ensure expenditures are charged to the proper funding source

Criteria: Expenditures should be charged to the appropriate fund based on accurate supporting documentation. In addition, Arizona Revised Statutes (A.R.S.) §42-6109.01 requires that jail tax monies collected pursuant to this statute be disbursed to maintain and operate adult and juvenile jail facilities.

Condition and context: During fiscal year 2010, the County alleged that employees had been paid from the Detention Operations Fund but were not always performing responsibilities to maintain and operate adult and juvenile jail facilities. For fiscal year 2010, the Detention Operations Fund had payroll expenditures totaling $218 million. However, it is unknown the extent of the misspending, if any, as of the report date.

Effect: Expenditures in the Detention Operations Fund and General Fund could be misstated. Also the County could be in noncompliance with A.R.S. §42-6109.01. This finding is a material weakness in internal control over financial reporting and an instance of noncompliance.

Cause: Employees within the Sheriff's Department allegedly were transferred between law enforcement and detention assignments; however, there was no mechanism in place to track and correct the impact to expenditures.

Recommendation: The County should investigate and determine the financial impact of this finding and make appropriate corrections. In addition, the Sheriff's Department should develop procedures to ensure that payroll expenditures are charged to the correct funding source so that it complies with A.R.S. §42-6109.01.

Maricopa County
Department of Finance

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February 4, 2011

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 names of the contact persons responsible for the corrective action, the corrective action planned, and the anticipated completion date for each finding included in the Report on Internal Control and Compliance.

Sincerely,

Shelby L. Scharbach
Chief Financial Officer

Maricopa County
Corrective Action Plan
Year Ended June 30, 2010

10-01
The County should improve capital asset reporting
Contact persons: Mark Modin, Finance Manager, Maricopa County Department of Transportation, (602) 506-8644; Bridget Harper, Financial Supervisor, Department of Finance, (602) 372-3505
Anticipated completion date: March 2011

Concur. The County recognizes the significance of accurately accounting for its capital assets and is in the process of revising and implementing County-wide policies and procedures. The Department of Finance has Board-approved capital asset policies and draft infrastructure policies and procedures, which are currently being revised and are available to departments on the intranet. In addition, the Department of Transportation will revise their internal written policies and procedures to accurately categorize transportation infrastructure assets and will review the audit recommendations and implement controls for joint projects with other governments and annexations. The Department of Transportation will continue to use an infrastructure project plan to list each action item and its due date to manage the reporting process. Further, the County will continue to seek opportunities to improve its policies and procedures over infrastructure assets.

10-02
The County should investigate and resolve unreconciled differences for cash and investments between the Finance Department's and County Treasurer's records
Contact person: Mayra Salcido, Financial Supervisor, Department of Finance, (602) 372-3506
Anticipated completion date: November 2011

Concur. The County recognizes the importance of accurately accounting for and reporting its cash and investments. The County will implement a separate and new reconciliation process in order to ensure cash and investments are properly reconciled between the Finance Department's and Treasurer's Office systems.

10-03
The County should strengthen logical access controls to its computer systems.
Contact person: John Lewis, Deputy Director, Department of Finance, (602) 506-1373
Anticipated Completion Date: Recommendation item #1- March 2011, #2 – 3 Completed

Concur. The County recognizes the importance of maintaining strong internal controls over access to its computer system. The County has updated user profiles to ensure that employees cannot perform incompatible duties. However, the County still has two "super" users and will implement review procedures to adequately monitor their system activities. In addition, the County changed its vendor registration procedures and no longer allows the creation of new vendors without proper approval. Although, vendors could be registered prior to final approval during fiscal year 2010, payments were not generated to these vendors without final vendor approval and a properly authorized purchase order. However, due to the existence of "super" users, review procedures will be implemented to ensure a vendor and payment to such vendor are not created and approved outside the internal controls in place.

Maricopa County
Corrective Action Plan
Year Ended June 30, 2010

10-04
The County should ensure expenditures are charged to the proper funding source
Contact person: John Lewis, Deputy Director, Department of Finance, (602) 506-1373
Anticipated Completion Date: June 2011

Concur. On September 22, 2010, the Maricopa County Board of Supervisors adopted a resolution to review the Sheriff's Office financial transactions regarding the alleged misspending of Detention Operations Fund monies. As a result of this resolution, the County implemented a Financial Review Committee (Committee). The Committee consists of members from the Internal Audit Department, the Finance Department, the Sheriff's Office, and the Office of Management and Budget. The Committee is in the process of developing a methodology for analyzing payroll misspending potentially dating back to 2004. Based on the volume of records to be analyzed, it is estimated that this financial review will take several months to complete. The Committee is also working with the Auditor General's Office to ensure the financial review performed and the supporting documentation collected will be sufficient for the annual financial statement audit.

Maricopa County

Report on Internal Control and Compliance

Year Ended June 30, 2010

State of Arizona

Office of the Auditor General