A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Management Letter

# Maricopa County

Year Ended June 30, 2006

**Debra K. Davenport**
Auditor General

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STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

March 11, 2008

Board of Supervisors
Maricopa County
301 West Jefferson, Suite 1020
Phoenix, AZ 85003

Members of the Board:

In planning and conducting our single audit of Maricopa County for the year ended June 30, 2006, 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 in the GAS and OMB Circular A-133 reports have been included in the County's Single Audit Reporting Package for the year ended June 30, 2006. 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.

This letter is intended solely for the information of the Maricopa 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

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# The County needs to improve capital assets reporting

Capital assets represent more than 67 percent of the County's total assets. Therefore, it is essential that the County accurately report these assets in its financial statements and maintain control over them. The County has written capital assets policies that require the department responsible for a capital asset to notify the Department of Finance when assets are disposed of. However, county departments did not always follow these capital asset policies and procedures. As a result, the County removed land, buildings, and equipment valued at $11 million from its accounts in fiscal year 2006 that had been disposed of in prior fiscal years.

To help ensure that the County maintains physical control over its capital assets and accurately reports them, the County should enforce its existing policies that require departments responsible for capital assets to notify the Department of Finance when assets are disposed of or during the year-end verification process. The Department of Finance can then remove these capital assets from the capital assets system.

# The County must collateralize all deposits as required by statute

The County maintained deposits in bank accounts that exceeded federal depository insurance. Arizona Revised Statutes (A.R.S) §35-323 and the County's written policies and procedures require eligible depositories, before receiving a deposit in excess of the insured amount, to deliver collateral equal to at least 101 percent of the deposit. However, the County did not always follow statute or its policy. Specifically, at June 30, 2006, $12 million of the County's bank balance was uninsured and uncollateralized. No loss of public monies resulted from these uninsured and uncollateralized deposits, however, to protect public monies from potential loss and to comply with statute, the County must ensure that all deposits not covered by federal depository insurance are collateralized in accordance with A.R.S. §35-323.

## The Treasurer should ensure that responsibilities over investment transactions are separated

The Treasurer is responsible for managing and investing more than $3 billion in public monies belonging to the County, school districts, and other special districts in the County. Therefore, it is essential that the Treasurer have internal controls to ensure that those monies are adequately safeguarded against loss, misappropriation, and abuse, and are invested as authorized by the Treasurer's policies. However, the Treasurer did not adequately separate its investing responsibilities. For example, the Treasurer's chief investment officer was responsible for initiating, evaluating, and approving investment transactions with no required independent review. As a result, investments might be purchased that are not authorized by the Treasurer's investment policies or that are not the most advantageous to the Treasurer's investment pool.

To safeguard public monies and help ensure that investments are in accordance with policy and are the most advantageous to the investment pool, the Treasurer should separate responsibilities so that the same employee does not initiate, evaluate, and approve investment transactions. Alternatively, the Treasurer could institute independent reviews over these activities.

The Treasurer's Office officials responded in a letter, dated January 29, 2008, that they do not concur with our recommendations. The response addresses current controls to ensure that the transactions are complete and recorded in the County's records. It also points out that even with the optimum controls, there is the risk that an allowable investment is subject to loss and could decline in value. Our recommendations would enhance controls to ensure that only investments authorized by statute and the Treasurer's policies were made, rather than to ensure that the transactions are recorded properly in the accounting records or attempt to mitigate the risk of loss, which is inherent to some degree with all investments.

## The County needs to improve access controls for its information systems

The County uses computerized information systems to process and record its financial transactions. Consequently, the County's information systems are vital to its operations and financial reporting. Therefore, the County needs to ensure the integrity of the financial transactions processed on these systems. However, the County did not have adequate procedures to ensure that appropriate access was granted to its systems. Specifically, the County did not have adequate controls in place to ensure that employees only had access to computerized functions that were compatible with their job responsibilities.

To help ensure the integrity of financial information and to help mitigate the risk of loss caused by misappropriation, theft, or abuse, the County should implement policies and procedures to require systems security and department administrators to review employee access to ensure that it is compatible with assigned job responsibilities and that responsibilities are properly separated. If department administrators find computer access that is incompatible with an employee's responsibilities, they should revoke that access. When circumstances exist that require an employee to have access that is incompatible with their job responsibilities, a supervisor should review the employee's computer activity.

## The County needs to implement previously reported recommendations

We have reported to the County certain deficiencies noted during our previous audits that should be corrected to improve county operations. However, the County has not implemented the recommendations to correct these deficiencies. Our Office reported detailed descriptions of these deficiencies and the related recommendations in our prior years' Management Letters.

Related party transactions—Financial accounting standards require that financial statements include disclosures of material related party transactions. The County's procurement policies require anyone with a potential conflict of interest to inform appropriate county management. Although the County's policy is consistent with A.R.S. §38-503 regarding conflicts of interest, it did not provide procedures to identify, account for, and report related party transactions. The County should require all public officers and employees having purchasing, spending, or investing authority to file conflict-of-interest statements. The County should also review all conflict-of-interest and financial disclosure statements that were filed by county employees and elected officials to identify potential related party transactions and disclose them if appropriate.

Information systems disaster recovery—The County has not established a disaster recovery plan or written backup agreement for its payroll information system. Without such a plan or agreement, financial transactions might not be accurately processed if a disaster occurred. To help strengthen controls over the payroll information system, the County should establish a disaster recovery plan or written backup agreement.

Cash Receipts—Because cash is highly susceptible to potential theft or misuse, county management should establish, monitor, and enforce effective controls to safeguard cash receipts at the various departments. However, the County lacked detailed written policies and procedures to provide guidance to the departments for collecting, recording, reconciling, and depositing cash receipts. To help strengthen controls over departmental cash receipts, the County should establish written procedures for collecting, recording, reconciling, and depositing cash receipts and periodically monitor that departments are following them.

Procurement Cards—While certain procurement card (p-card) purchases, such as gift cards for employees, are allowable as incentives under the County's employee compensation plan, the County did not have written policies and procedures providing guidance to departments to properly implement an employee incentive program using p-cards. Since p-card purchases are susceptible to potential misuse, the County should establish written procedures that provide guidance for purchases for employee incentive programs.

# Maricopa County

Department of Finance

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February 27, 2008

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

Dear Ms. Davenport:

Maricopa County values the input and recommendations from the Office of the Auditor General, as discussed within the June 30, 2006, Management Letter. Prior to the issuance of the Management Letter, the County on its own accord implemented several recommendations that include in part; working with various departments to improve capital asset reporting and an evaluation of employee user profiles in the financial system to ensure that adequate internal controls are in place. The County is currently reviewing the collateralized deposits finding to ensure that all monies in excess of federal depository insurance are covered by collateral.

Although the County has historically provided a detailed response to each recommendation, the County has decided to provide only a summary response to the June 30, 2006, Management Letter as shown in the above paragraph. The County is currently undergoing the fiscal year 2007 audits; therefore, the County is focusing its attention to the timely completion of those audits. In the future, the County will be providing a detailed response to the Management Letters. As previously stated, the County values the recommendations of the Office of the Auditor General and the County continually reviews and implements many of their recommendations.

The Maricopa County Treasurer's Office has responded to Recommendation 3 which is provided on the following page.

If you have any questions or comments, please contact me at (602) 506-1367.

Shelby L. Scharbach
Deputy Finance Director

Maricopa County
Treasurer

Charles "Hos" Hoskins, Treasurer
301 West Jefferson St., Rm. 100
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January 29, 2008

Ms. Kathleen Wood
State of Arizona, Office of the Auditor General
2910 N. 44th Street, Suite 410
Phoenix, AZ 85018

RE: Audit Finding Regarding Maricopa County Treasurer

Dear Ms. Wood:

We have reviewed your audit finding for the Maricopa County Treasurer's Office, to be included in the audit for Maricopa County. We still do not concur with your conclusions.

The investment functions are properly segregated to protect the pool participants from loss due to unauthorized use, damage, or modification of investments. The investment office operates directly under the authorization of the County Treasurer, who is solely responsible for the investments of the investment pool per ARS § 35-323(A). The Maricopa County Treasurer established the limits of the investments as outlined by ARS § 35-323 and the investment officer purchases said investments according to those directions. Any investment outside the defined parameters (such as registered warrants) are reviewed and discussed by the Treasurer, Chief Deputy, Investment Officer and the Accounting Manager to insure that the investment is safe and secure.

The investment officer purchases the investments as instructed and records the details of the transactions on the investment system that was designed for his use. He records the nature and details of the investment transactions. The details are then submitted electronically to accounting for verification

The accounting group will print a copy of the investment summary and match the detailed information provided by the bank's daily transaction report (an independent source) daily. The investments purchased, matured, sold, and any related interest received, are verified. The net cash is then matched to the bank statement to insure that the total dollars transacted match the reported investment transactions. Any questions are reported to the accounting manager or supervisor for research and resolution.

Upon verification of the details with the cash deposited or expended, the electronic data is released and posted to the accounting general ledger and to the treasurer's receipt system. The investment officer does not have the ability to modify or reverse the posted transactions on the accounting database.

Monthly, the accounting department will reconcile the bank safekeeping record, the investment officer's portfolio and the accounting investment funds to insure that all items are in agreement. The reconciliation is reviewed by the accounting manager. Any exceptions are reported to the accounting manager.

The process has three sources to verify the transactions to insure proper accounting and protection of the investment dollars.

The audit finding concludes that investments "might" be purchased to the disadvantage of the investment pool. The use of this term points out the speculative nature of this finding. In point of fact, there is no evidence of any of the deleterious events suggested by the audit of ever having occurred.

Additionally, the recommendation of multiple parties reviewing the same transaction does not prevent these unfortunate speculations from occurring. For example, the State Treasurer has a much larger investment staff. They have the redundancies suggested by your finding in place. Additionally, the Treasurer maintained an Advisory Committee in addition to its own staff. Nevertheless, in 2001, the State Treasurer invested $131 million from the Local Government Investment Pool ("LGIP") in National Century Financial Enterprises ("NCFE"). This investment was in commercial paper, which is permitted by statute. In 2002, NCFE became defunct. All of the participants in the LGIP lost money. Although there has been some recapture of these dollars, the magnitude of the loss remains severe. Several cities have moved their money from the LGIP and have chosen to invest on their own. The Maricopa County Treasurer, with its investment manager, and without the redundancies suggested on every transaction, did not invest in NCFE and did not lose one dollar of public money.

This is fact, not conjecture. Implementing the suggestions of the audit does not provide a guarantee that bad investments won't be made. Competent, conservative investment managers are the best defense against a loss. We believe the primary job of the Treasurer is to protect principal, with the secondary goal to maximize profits.

Sincerely,

Steve Partridge
Chief Deputy Treasurer