A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Management Letter

Maricopa County
Year Ended June 30, 2002

STATE OF ARIZONA
OFFICE OF THE
AUDITOR
GENERAL

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

June 26, 2003

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, 2002, 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 by GAS and OMB Circular A-133 have been included in the County's Single Audit Reporting Package for the year ended June 30, 2002. 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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TABLE OF CONTENTS

The County needs to improve capital assets reporting

Capital assets comprise over 60 percent of the County's total assets. Therefore, it is essential that the County accurately reports these assets to its lenders, the public, and other interested parties. To accomplish this, it must maintain a reliable capital assets system and have procedures in place that accurately identify, accumulate, and reconcile capital assets and related depreciation costs. However, the County did not always follow its established internal control policies and procedures to ensure its capital assets were accurately reported. Specifically, County departments did not always perform physical inventories in a timely manner to ensure that all assets were listed on the capital assets system as of June 30. In addition, the County recorded incorrect locations, tag numbers, useful lives, and accumulated depreciation for many machinery and equipment items on the capital assets system. Furthermore, the County's capital assets reconciliations were not sufficiently detailed to ensure that capital assets and depreciation balances were properly reported and classified in the financial statements.

The following procedures can help the County accurately record its capital assets on the capital assets system and report those assets accurately in its financial statements.

- Follow established internal control policies and procedures to ensure the capital assets system contains accurate and complete capital assets information that supports the amounts reported within the County's financial statements. For example, County departments need to perform timely and accurate physical inventories of assets held at June 30 and ensure that all assets that meet the requirements of the County's capitalization policy are accurately recorded on the system. In addition, the Finance Department needs to ensure it updates the capital assets system for all departmental physical inventories.

- Reconcile the capital assets system to the capital assets and depreciation balances reported in the financial statements. Specifically, the County should reconcile capital expenditures from the financial accounting system to items added to the capital assets system. In addition, the County should reconcile capital assets and related accumulated depreciation balances reported on the financial statements to the current year balances recorded on the capital assets system taking into account assets acquired and disposed of during the year and depreciation expense recorded for the year. All reconciling items should be supported by documentation and all necessary corrections should be made to ensure the capital assets system supports reported balances.

Departments should effectively control cash receipts

Because cash is highly susceptible to potential theft or misuse, County management should establish and enforce effective controls to safeguard cash receipts at the various departments. However, many departments lacked effective controls to properly safeguard and account for cash receipts. In addition, departments allowed employees to perform incompatible duties, such as recording and reconciling cash receipts. Specifically,

- The *County Attorney's Office* had not established an accounts receivable system to account for the assessment fees the contracted program administrator owed for first-time drug offenders. Consequently, the Office could not ensure that the administrator remitted the proper amounts collected.

- The *Flood Control District* did not account for the sequential issuance of cash receipt forms.

- The *Library District* did not lock its cash drawer during business hours, which allowed all employees to have access to its cash and checks.

- The *Sheriff's Office Tax Division* and the *Transportation Department* did not deposit significant cash receipts daily.

- One employee recorded and reconciled cash receipts (*Emergency Management, Flood Control District, Transportation Department*). No complete review of documentation was performed by a separate employee to ensure that all monies collected were deposited.

- At the *Office of the Medical Examiner*, the employee who prepared report copies also collected and recorded the associated fees. Further, the Office did not assign a separate employee to reconcile cash collected to the number of copies made.

To properly account for and safeguard cash, County management should establish uniform policies and procedures to address weaknesses noted in order to ensure proper controls over cash receipts and separation of employee responsibilities. Further, County management should enforce and monitor departmental compliance with the policies and procedures established.

The County should ensure that departments properly administer and report federal financial assistance

The County received over $100 million in federal financial assistance during fiscal year 2002. Consequently, the County needs to ensure that departments administer federal programs in accordance with federal rules and regulations to ensure the County does not lose some of its federal monies or have to repay the federal government for unallowable costs. However, several departments did not comply with federal rules and regulations, examples of which follow:

Allowable costs/cost principles—Office of Management and Budget (OMB) Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments, Attachment B(11)(h) requires that the County charge federal programs for expenditures that are allowable and therefore, such expenditures need to be properly supported. However, the Adult Probation Department charged unallowable payroll expenditures of $930 to the Consolidated Knowledge Development and Application Program. In addition, the Department of Public Health did not adequately support payroll expenditures totaling $57,427 charged to the Preventive Health Services—Sexually Transmitted Diseases Control Grants program. These unsupported payroll expenditures did not result in a questioned cost because monies drawn down for this program were in accordance with a fixed-rate agreement that paid the County based on the reporting of services performed.

Reporting—The Programmatic Guidance for the Consolidated Knowledge Development and Application Program requires that the Government Performance and Results Act (GPRA) 6- and 12-month followup reports be prepared for program participants within 30 days of those time frames. The Adult Probation Department did not always prepare or did not prepare in a timely manner these reports. In addition, its cash drawdown requests and Federal Cash Transaction Reports were not reviewed by someone other than the preparer. Consequently, the lack of a supervisory review could result in incorrect drawdown amounts and the improper reporting of monies drawn down and expended.

SEFA reporting—OMB Circular A-133 requires governments to prepare a Schedule of Expenditures of Federal Awards (SEFA) each year showing federal programs and corresponding expenditures along with any related pass-through grantors, numbers, and expenditures. However, the County incorrectly reported a pass-through grantor and many pass-through grantor numbers and pass-through amounts to subrecipients. In addition, the County incorrectly reported expenditures for 14 programs, excluded expenditures for 7 programs, and did not accurately identify a program cluster. The SEFA was adjusted for these errors, which had caused expenditures to be overstated by $735,347.

County management should establish the necessary procedures to help ensure that program administrators are aware of all applicable federal program requirements, as included in the County's grants manual, and should monitor the departments to ensure these requirements are being followed. In addition, the Finance Department should properly support and confirm program information reported on the SEFA with the department responsible for administering each program, and review the information for completeness and accuracy.

The County needs to implement previously reported recommendations

We have reported to the County certain deficiencies noted during our previous audits that are significant and should be corrected to improve County operations. However, the County has not implemented the recommendations designed to correct these deficiencies. Detailed descriptions of these deficiencies and the related recommendations were reported in our Management Letter for the year ended June 30, 2001.

Related party transactions—Financial accounting standards require that financial statements include disclosures of material related party transactions. However, the County did not require all public officers and employees having purchasing, spending, or investing authority to file conflict-of-interest statements and it did not review conflict-of-interest and financial disclosure statements that were filed by County employees and elected officials to identify potential related parties. A recommendation to correct this deficiency has been suggested to the County since fiscal year 1994. It's important to disclose material related party transactions in the financial statements so that users are aware of the volume of financial activity that may not result from arms-length transactions.

Information systems disaster recovery and user access—The County has not established disaster recovery plans and written backup agreements for systems critical to the County's operations. Without such plans or agreements, financial transactions might not be adequately processed if a disaster occurred. In addition, the County has several users with a high level of access to the Advantage Financial System, which would allow them to both initiate and approve financial transactions. Furthermore, it was not documented as to whether management reviewed reports that summarized changes in user access. Recommendations to implement disaster recovery plans, including written backup agreements, and to restrict user access have been suggested to the County since fiscal years 1995 and 2000, respectively. It's important that the County implement these recommendations to help maintain system integrity and security.

Maricopa County
Department of Finance

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June 23, 2003

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

Dear Ms. Davenport:

The management of Maricopa County is responsible for establishing and maintaining a system of internal controls. Internal accounting controls are designed to provide reasonable, but not absolute assurance regarding: 1) the safeguarding of assets against loss from unauthorized use or disposition; and 2) the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that: 1) the cost of a control should not exceed the benefits likely to be derived; and 2) the evaluation of costs and benefits requires estimates and judgments by management.

All internal control evaluations occur within the above framework. We believe that Maricopa County's accounting controls adequately safeguard assets and provide reasonable assurance that financial transactions are properly recorded.

County management takes the issues addressed in the Management Letter very seriously. It is the intention of Maricopa County management to review the areas included in the Management Letter, determine, and implement the corrective action(s) necessary.

The County believes that the capital asset financial transactions are properly recorded and reported. Specifically regarding the capital asset reporting, the County has raised the level of focus regarding the management and reporting of capital assets. The capital asset program includes: 1) monthly reconciliations to ensure all capital expenditures are properly recorded which includes a regular report to county management regarding the activity; and 2) monitoring of the Annual Validations. The Department of Finance maintains a report that tracks and monitors the departmental compliance with the Annual Validation requirement as defined in the County Capital Asset Manual. The County maintains a focus of continuous improvement. Therefore, the County will continue to review all opportunities to enhance the Capital Asset Program.

Specifically regarding Cash Handling, the County ensures that adequate internal controls are in place to ensure the proper accounting for cash. Each department noted in the Management Letter will be forwarded the information for review. The Department of Finance will ask that each department take corrective action to address each cash handling issue and to make sure that the finding does not occur in the future.

The County continues to enhance the management and reporting of grant activity. Although the State Auditor General indicates an overstatement of $735,347, this results in an overall overstatement of less than 1% of our total Federal funding of approximately $100 million. The County works closely with the grantors to ensure the terms of the grant agreements are followed. Each department noted in the Management Letter will be forwarded the information for review. The Department of Finance will ask that each department take corrective action to address each issue.

Previously reported recommendations addressed by the State Auditor General includes 1) Related Party Transactions, 2) Information Systems Disaster Recovery and 3) User Access. The County believes that the current procedures associated with Related Party Transactions meet the requirements of A.R.S. 38-503 - Conflict of interest; exemptions; employment prohibition. In addition, the County believes that the current process and/or procedures of maintaining complete off-site backup of all critical financial and tax data are adequate to ensure the continuity of County functions. The County further believes that the current number of super-users is necessary to ensure the continuity of the system.

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

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Shelby Scharbach
Deputy Finance Director