A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Management Letter

Maricopa County

Year Ended June 30, 2003

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

July 9, 2004

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, 2003, 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, 2003. 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.

In addition, as required by Arizona Revised Statutes §41-1279.21(A)(1), we reviewed the County's financial records to evaluate whether the County used Highway User Revenue Fund monies and any other dedicated state transportation monies solely for authorized transportation purposes. However, we have requested an opinion from the Arizona Attorney General about whether certain types of county transportation department expenditures are for transportation purposes authorized by the Constitution and state laws, but have not yet received a response to our request. Once we receive the opinion, we will complete our review and report any instances of noncompliance in a separate letter.

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

2910 NORTH 44th STREET • SUITE 410 • PHOENIX, ARIZONA 85018 • (602) 553-0333 • FAX (602) 553-0051

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The County should improve departmental controls over 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, the County lacked detailed written policies and procedures to provide guidance to the departments for collecting, recording, reconciling, and depositing cash receipts. Also, the County did not monitor the receipt procedures being followed at the individual departments. As a result, the County Attorney's Office did not have a system in place to properly account for assessment fees. In addition, the Sheriff's Tax Division and the Transportation Department did not deposit significant cash receipts daily. Furthermore, at the Office of the Medical Examiner, one employee had incompatible responsibilities, such as collecting, recording, and reconciling fees collected for report copies.

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. These procedures should include the following:

- Establish accountability for cash receipts when collected by assigning a unique transaction number to an individual receipt. The transaction numbers should be sequentially controlled for proper accountability.

- Maintain an accounts receivable system, when necessary, to properly account for those monies, such as assessment fees, that are susceptible to accrual.

- Restrictively endorse all checks "for deposit only" immediately upon receipt.

- Record all cash receipts when collected in either a mail log, a cash register system with locked-in totals, or in the department's computer system.

- Reconcile daily the totals from the sequence of receipts collected to the monies recorded and deposited. This reconciliation should be performed daily and any differences should be investigated and resolved.

- Deposit cash receipts intact daily. Any small dollar cash receipts should be deposited at least weekly.

- Separate responsibilities between employees so that the employee with access to cash receipts is not responsible for recording and depositing the receipts. In addition, the daily reconciliations should be reviewed by a supervisor. If responsibilities cannot be adequately separated because of small staff size then a supervisor should review and approve transactions and related reconciliations.

The County should properly administer and report federal financial assistance

The County received over $100 million in federal financial assistance during fiscal year 2003. Consequently, the County needs to ensure that departments administer federal programs in accordance with federal laws and regulations to make certain that these monies are only used for their intended purposes so that the County does not lose some of its federal funding or have to repay the federal government for unallowable costs. However, several departments did not comply with federal laws and regulations, as follows:

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 should be properly supported. The Adult Probation Department tracks payroll expenditures for a federal grant using specific reporting categories on the Advantage Financial System. However, during fiscal year 2003, payroll expenditures of $5,300 pertaining to employees not working on the Consolidated Knowledge Development and Application Program were charged to the program's reporting categories. The Department was unable to determine which employees were incorrectly charged to the program. As the Department based actual drawdowns of federal monies on the individual employee's payroll records and not what was recorded in specific reporting categories, the total questioned cost for this error was only $2,764.

Earmarking—45 Code of Federal Regulations §1305.6(c) requires that at least 10 percent of the Head Start program's enrollment opportunities be made available to children with disabilities. However, the Human Services Department only made available 9.1 percent of enrollment opportunities to children with disabilities. The Department made an effort to comply with the requirement, but did not request an exception from the grantor.

Reporting—The Maricopa County Public Health Department Immunization Grants program reports vaccine inventory levels and places an order to replenish inventory with the Arizona Department of Health Services on a monthly basis. During fiscal year 2003, Public Health administered a total of $4.9 million of vaccines.

Consequently, it is important for the County to report accurate inventory accounts and usage to avoid temporary overages and shortages in inventory levels. The Department misreported the total number of vaccines administered on the August 2002 and May 2003 inventory reports. Auditors also noted that inventory reports were not reviewed by a supervisor prior to submission. These inventory errors were corrected as of the June 2003 inventory report. Therefore, these errors did not affect vaccines received in total for fiscal year 2003 or the dollar amount of vaccines reported as expenditures on the Schedule of Expenditures of Federal Awards (SEFA).

Subrecipient Monitoring—During fiscal year 2003, the Adult Probation Department passed through $207,773 to a subrecipient for the Consolidated Knowledge Development and Application Program, but did not have specific written policies and procedures that included evaluating whether the subrecipient met the thresholds for requiring an audit, as prescribed by Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* As a result, the Department did not comply with certain subrecipient monitoring procedures prescribed by OMB Circular A-133, Subpart D, §.400(d). Specifically, the Department did not evaluate whether the subrecipient expended greater than $300,000 in federal awards to ensure they received an OMB Circular A-133 audit. As a result, the Department could not ensure that the subrecipient is complying with all applicable program requirements. This finding did not result in a questioned cost because the Department has other subrecipient monitoring procedures in place that help ensure the subrecipient is materially complying with applicable program rules and regulations.

Schedule of Expenditures of Federal Awards (SEFA) reporting—OMB Circular A-133 requires the County to prepare a SEFA each year showing the federal programs administered by the County and the corresponding expenditures along with any related pass-through grantors, numbers, and expenditures. However, the County incorrectly reported program titles, pass-through grantors, pass-through grantor numbers, and pass-through amounts to subrecipients. Also, the County incorrectly reported expenditures on the SEFA for 14 programs and did not accurately identify a program cluster. In addition, the County did not correctly identify in the SEFA notes the programs included on the SEFA that reported all monies expended in the fiscal year received (i.e., cash basis). The SEFA was adjusted for these errors, which would have caused expenditures to be overstated by $6.3 million. Furthermore, eight departments responsible for administering programs had to make manual adjustments to expenditures recorded on the County's financial accounting system in order to properly report expenditures on the SEFA.

The County must ensure that federal monies they administer are used in accordance with federal laws and regulations. To help ensure these monies are spent in compliance with federal requirements, county management should establish 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. Finally, departments should properly record program expenditures on the County's financial accounting system.

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 designed to correct these deficiencies. Our Office reported detailed descriptions of these deficiencies and the related recommendations 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. Maricopa 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 Arizona Revised Statutes §38-503 regarding conflict of interest, it does not provide for the identification and accounting for related party transactions. Specifically, 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 its computer information 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

Tom Manos
Chief Financial Officer
301 West Jefferson Street
Suite 950
Phoenix, AZ 85003-2278
Phone: 602.506-3561
Fax: 602.506-4451
www.maricopa.gov

July 2, 2004

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.

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.

Specifically regarding Cash Receipts, the County ensures that adequate internal controls are in place to ensure the proper accounting for cash. The County continues to provide training in cash handling. The course curriculum focuses on effective control techniques for processing cash receipts. The class includes: the importance of effective controls over cash; basic risks and control techniques for receipting, depositing, accounting (for), and reconciling cash; evaluation of cash handling procedures in place in the department; and action plans to address risk of loss. 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(s) as necessary to address each issue. In addition, each department will be strongly encouraged to attend the next available cash handling class.

The County continues to enhance the management and reporting of grant activity. The County works closely with 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(s) as necessary 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. Although the County believes that the current procedures associated with Related Party Transactions are adequate to ensure arms-length transactions, the County will review the potential opportunities to determine if enhancements are warranted. In addition, the County concurs, in part, regarding the lack of written disaster recovery plans. The County believes that the current process and/or procedures of maintaining complete off-site backup of all critical financial information are adequate to ensure the continuity of County functions. The County has contracted with an outside vendor (Infocrossing) to manage the Advantage Financial data. Included in this contract is the development of a Disaster Recovery plan, which will be implemented in FY05, which will further meet the requirements of County Policy A1602 - Disaster Recovery issued January 2002. The County further believes that the current number of super-users is necessary to ensure the continuity of the system and is not planning to make modifications in this area.

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

Shelby Scharbach
Deputy Finance Director