A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Report on Internal Control and Compliance

Maricopa County

Year Ended June 30, 2012

Debra K. Davenport
Auditor General

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Maricopa County
Report on Internal Control and Compliance
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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, each major fund, and aggregate remaining fund information of Maricopa County as of and for the year ended June 30, 2012, which collectively comprise the County's basic financial statements, and have issued our report thereon dated December 21, 2012. 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, and Employee Benefits Trust Funds, 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

The County's management is responsible for establishing and maintaining effective 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 a deficiency in internal control over financial reporting that we consider to be a material weakness and another deficiency that we consider to be a significant deficiency.

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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 deficiency described in the accompanying Schedule of Findings and Recommendations as item 12-01 to be a material weakness.

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 deficiency described in the accompanying Schedule of Findings and Recommendations as item 12-02 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 and those of the other auditors disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standard*s.

Maricopa County's responses to the findings identified in our audit are presented on pages 5 and 6. 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 21, 2012

12-01
The County should follow its policies and procedures when preparing financial statements and note disclosures

Criteria: The County should follow generally accepted accounting principles (GAAP) and the County's policies and procedures when compiling financial statements and note disclosures. Specifically, Governmental Accounting Standards Board (GASB) Statement Nos. 10 and 56 require that when a loss is probable and reasonably estimable at fiscal year-end, the expenditure and liability should be recognized in the financial statements. In addition, the liability and expenditure should be increased to the actual loss if the claim is settled prior to financial statement issuance. Further, expenditures should be recognized in the fiscal year that goods or services are received.

Condition and context: The County did not consistently follow GAAP when recording its liabilities and expenditures for contingent liabilities and contracted services on the financial statements. Specifically, the County did not record a contingent liability for indigent health care claims of $45 million that was reasonably estimable at June 30, 2012, and settled in December 2012 before the financial statements were issued. In addition, the County did not always record liabilities and expenditures for contracted services received in prior fiscal years when a portion of the payment was retained by the County until the project was completed. As a result, the County incorrectly recorded $10.3 million in the current fiscal year as expenditures related to payments made on contracted services performed in the prior fiscal year.

Effect: The claims payable liability and expenses/expenditures were understated by $45 million in the Governmental Activities and General Fund. In addition, the beginning fund balance and current year capital outlay expenditures in the General Fund County Improvements Fund were both overstated by $10.3 million. The County's financial statements and note disclosures were adjusted to correct the errors.

Cause: The County did not believe the amount associated with the contingent liability could be reasonably estimated at June 30, 2012, as this amount historically had not been estimable. Also, the County did not properly account for monies retained for contracted services in prior years as a liability and expenditure because of employee turnover.

Recommendation: The County should follow GAAP and the County's policies and procedures when compiling its financial statements and note disclosures. Estimable contingent liabilities and all monies retained for goods and services received should be recognized as both a liability and expenditure in the financial statements and note disclosures.

12-02
The County should better monitor controls over its outside service organization

Criteria: The County should have a process in place to review audits of its outside service organization which outline both the service organization's and County's responsibilities over controls and any internal control weaknesses that could affect the service organization's information system. In addition, when relying on a service organization's information system, the County should verify that testing is being completed on the disaster recovery plan and obtain the results of those tests.

Condition and context: The County used an outside service organization's computer system to process its payroll transactions and relies on the service organization's internal controls to ensure that payroll is processed accurately and personnel records are safeguarded. The service organization had several audits to demonstrate its internal controls were operating effectively. However, the County did not request or review the audit reports during the fiscal year. Further, the County did not request a copy of the service organization's disaster recovery plan to determine whether the information system could function in the event of a system or equipment failure. The County subsequently obtained and reviewed the audit reports and test results of the disaster recovery plan after the auditors brought it to its attention.

Effect: There is a risk that the County may not have adequate internal controls in place over its payroll system that could lead to potential theft, manipulation, or misuse of confidential or sensitive data. Additionally, the County may not be able to process payroll transactions in the event of system or equipment failure if the service organization does not have a disaster recovery plan in place.

Cause: This was the County's first year using the service organization, which resulted in some confusion over who was responsible for obtaining and reviewing the necessary audit and disaster recovery documentation.

Recommendation: The County should establish and implement internal control procedures to obtain and review its service organization's audit reports. In addition, the County should request the service organization's annual disaster recovery plan's test results over its payroll system.

COUNTY RESPONSE

Maricopa County

Department of Finance

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February 8, 2013

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

Maricopa County
Corrective Action Plan
Year Ended June 30, 2012

12-01
The County should follow its policies and procedures when preparing financial statements and note disclosures
Contact person: John Lewis, Deputy Finance Director, Department of Finance, (602) 506-1373
Anticipated Completion Date: Claims Liability – Completed
Contract Retention – June 30, 2013

Concur. Regarding indigent health care claims liability, the indigent health care litigation has been pending with the County for several years and has been inestimable throughout most of the claims litigation process. However, in June 2012, arbitration on the claims began and an estimate of the liability was determined. The County received the attorney letter regarding the estimated liability in late November 2012 and did not realize until the case settled in December 2012 that there was an estimable liability at June 30, 2012. Regarding retention payable, the balance of contracts retention payable at June 30, 2012, was recorded; however, prior year balances were not recorded or restated when determining the balance at June 30, 2012, due to oversight.

The County has existing policies and procedures in place to help ensure our financial statements and related notes are in compliance with generally accepted accounting principles. Specifically, we have procedures in place to evaluate pending litigation and its related liability, however, due to the nature of the claims in this case and the historical trend of being inestimable; the County overlooked the estimated liability reported in the applicable attorney letter. In addition, the County has procedures to identify outstanding contract retention liability and is improving the procedures to ensure that additions and reductions of those liabilities are properly accounted for.

12-02
The County should better monitor controls over its outside service organization
Contact person: Ryan Ellis, HRIS Senior Consultant, Deputy County Manager's Office, (602) 372-0496
Anticipated Completion Date: Completed

Concur. The County has established a thorough review process for all payroll system Service Organization Controls (SOC). The review process has been fully documented and adhered to for all SOC reports delivered by Maricopa's service provider, ADP. A complete analysis of user entity controls and findings for each report is conducted by the HRIS Senior Consultant in conjunction with the Office of Enterprise Technology and each business entity; Payroll & Records, Benefits, Recruiting, and ADP Security. The ADP SOC1 Review and Management procedure was finalized on August 8, 2012, after completing the first review of SOC reports delivered June 11, 2012. In addition, the County has added a quarterly review of the Disaster Recovery results to the Service Level Agreement review, conducted in joint effort by the Relationship and Service Management ADP representatives and the Executive Sponsorship and Business Owners of Maricopa County.

Maricopa County

Report on Internal Control and Compliance

For the Year Ended June 30, 2012

State of Arizona

Office of the Auditor General