A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Report on Internal Control and Compliance

Maricopa County

Year Ended June 30, 2014

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, 2014

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Report Issued Separately

Comprehensive Annual Financial Report

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, 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, the financial statements of the governmental activities, business-type activities, each major fund, and aggregate remaining fund information of Maricopa County as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the County's basic financial statements, and have issued our report thereon dated December 19, 2014. Our report includes a reference to other auditors who audited the financial statements of the Stadium District, Risk Management, Employee Benefits Trust, and the Housing Authority, 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 of the financial statements, we considered the County's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the County's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Recommendations, we and the other auditors identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and significant deficiencies.

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

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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 2014-01, 2014-02, and 2014-03 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 the deficiencies described in the accompanying Schedule of Findings and Recommendations as items 2014-04, 2014-05, 2014-06, 2014-07, and 2014-08 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the County's basic financial statements are free from 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 Standards*.

Maricopa County Response to Findings

The County's responses to the findings identified in our report are presented on pages 9 through 12. The County's responses were not subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the County's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the County's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Jay Zsorey, CPA
Financial Audit Director

December 19, 2014

Financial Statement Findings

2014-01

The County should follow its policies and procedures when valuing its capital assets

Criteria: The County should follow its policies and procedures to ensure its capital assets are accurately valued and reported in its financial statements and note disclosures in accordance with U.S. generally accepted accounting principles (GAAP). Accurate financial statements provide valuable information to those charged with governance and management and other financial statement users to make important decisions about the County's financial operations.

Condition and context: The County's capital assets total $3.5 billion, which is 71 percent of the County's total assets. Of this amount, $1.2 billion of its capital assets are maintained and accounted for by the Maricopa County Department of Transportation (MCDOT). Auditors noted that MCDOT was not following its policies and procedures to properly account for its transportation infrastructure assets. Specifically, MCDOT did not properly review its valuation schedule used to calculate its donated assets. The following additional valuation errors were noted with MCDOT's infrastructure capital assets:

- $21 million in assets were included in the beginning balance that were annexed by other municipalities in prior years and accordingly should have been deleted in prior years.
- $5.5 million of donated capital assets were not properly valued and included in the beginning capital assets balance or current year additions.
- $1.4 million of discontinued projects were recorded as construction in progress and categorized as a capital asset.

Effect: The County's financial statements were not initially prepared in accordance with GAAP for capital assets. The County made recommended audit adjustments to the financial statements and notes for the errors described above.

Cause: The County did not follow its established internal control policies and procedures to ensure capital assets are appropriately accounted for and valued. In addition, a programming error within the Road Management System caused errors in the valuation of donated transportation capital assets.

Recommendation: The County should consistently apply its policies and procedures to accurately account for and value its capital assets. Specifically, MCDOT should perform a thorough review of its valuation schedule used to calculate its donated assets. In addition, MCDOT should ensure that capital assets are properly accounted for in its accounting records by deleting capital assets that are annexed to other municipalities and accurately recording capital assets donated to the County. Further, construction in progress projects that are discontinued and asset purchases that do not meet the County's capitalization criteria should be expensed.

2014-02

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

Criteria: The County should follow its policies and procedure to ensure its financial statements are prepared in accordance with GAAP. Accurate financial statements provide valuable information to those charged with governance and management and other financial statement users to make important decisions about the County's financial operations.

Condition and context: The County's Department of Finance (Department) did not consistently follow GAAP when recording county revenues and net position. Specifically, the Department did not correctly account for all jail per diem revenues earned from other municipalities for housing inmates in its jails during fiscal year 2013 and collected within 60 days after year-end. This error resulted in a $3.6 million overstatement of charges for services revenues recorded in fiscal year 2014. In addition, the Department incorrectly eliminated revenues recorded in a previous fiscal year in the current year. This error resulted in a $2 million understatement of charges for services revenues and a $2 million overstatement in unearned revenues recorded in fiscal year 2014. Further, the Department misclassified approximately $2.6 million of unrestricted net position that should have been classified as net investment in capital assets.

Effect: The County's financial statements were not initially prepared in accordance with GAAP. The County made recommended audit adjustments to the financial statements for the errors described above.

Cause: The County did not properly review the financial statement data and schedules.

Recommendation: To help ensure the accuracy of the County's financial statements, the County should follow GAAP and the County's policies and procedures for compiling its financial statements.

2014-03

The County should strengthen controls over cash receipts

Criteria: Employees' responsibilities for collecting, recording, depositing, and reconciling cash receipts should be adequately separated. Further, a supervisory review should be performed over the cash receipts to ensure receipts are properly recorded and deposited.

Condition and context: The County did not have adequate controls over cash receipts for public safety services and jail per diem revenues. Specifically, during fiscal year 2014, the County collected a total of $9.4 million and $30.8 million in patrol service and jail per diem revenues, respectively. The Department of Finance was responsible for collecting and depositing these monies. However, the same employee was responsible for preparing the cash receipt transmittal to be recorded in the accounting system and depositing the receipts directly to the bank. In addition, no review was performed over the recording and depositing of these cash receipts and no reconciliation was performed to ensure all collections were properly recorded in the accounting system.

Effect: There is a risk of loss through error, theft, and fraud.

Cause: The County's policies and procedures over cash receipts were poorly designed.

Recommendation: To help strengthen controls over cash receipts and help ensure that all receipts are properly recorded and deposited, the County should:

- Separate cash receipts responsibilities to ensure the same person is not responsible for collecting, recording, reconciling, and depositing cash receipts.
- Perform a supervisory review of the cash receipt transactions and deposits, prior to recording them in the accounting system.
- Prepare a reconciliation of total cash receipts to all cash and checks received and investigate and resolve any discrepancies.
- Perform an independent management review of reconciliations performed between original receipts, deposits, and accounting ledgers.

2014-04

The County should monitor controls over its outside service organization

Criteria: The County should have policies and procedures in place to review audits of its outside service organization. Independent audits are an effective way to determine if transactions being processed by the outside service organization are accurate and complete and confidential data received is being properly safeguarded.

Condition and context: The County used an outside service organization to process its payroll and relies on the organization's internal controls to ensure that its payroll is processed accurately and employee records are properly safeguarded. The service organization had independent audits performed over its internal controls to help demonstrate that its internal controls were operating effectively; however, the County did not review these audit reports. The County subsequently obtained and reviewed the audit reports after the auditors brought it to their attention.

Effect: There is a risk that the outside service organization does not have adequate internal controls in place to appropriately process the County's payroll and ensure its employee records are properly safeguarded.

Cause: The County did not have policies and procedures in place to ensure the outside service organization's independent audit reports were obtained and reviewed.

Recommendation: The County should establish internal control policies and procedures to obtain and review its outside service organization's independent audit reports and require corrective action by the service organization for any internal control deficiencies reported that would affect the county payroll.

2014-05

The County should improve access controls over its information systems

Criteria: The County's information (IT) systems process and store information and data that is vital to its daily operations. Therefore, the County should have adequate policies and procedures to control access to its IT systems, including its network to help prevent and detect unauthorized use, damage, loss, or manipulation of its systems and data, and misuse of confidential or sensitive information.

Condition and context: The County did not have adequate policies and procedures in place to limit logical access to its IT information systems and network and physical access to its data center facilities. Specifically, auditors noted that for 3 of 20 employees' IT system access tested, the County did not maintain documentation authorizing the access granted because the access had been granted years ago. In addition, one employee's user access rights were not properly removed on the Treasurer's finance system and county network for over 3 months after the employee was terminated from the County. Further, for 5 of 6 employees tested with physical access to the data center, the County did not maintain documentation authorizing access to the facilities.

Effect: There is an increased risk that the County may not prevent or detect unauthorized access, use, damage, loss, or manipulation of its IT systems, network, and data center.

Cause: The County did not have adequate policies and procedures over review and approval of access granted or terminated to its IT systems, network, and data center.

Recommendation: The County should establish policies and procedures over access to its IT systems, network, and data center. In addition, the County should perform a periodic, comprehensive review of all existing users to help ensure that access granted to its IT systems and network is appropriate given the employees' job responsibilities. Further, the County should ensure terminated employees' access to its IT systems and network is terminated immediately.

Other auditors' findings:

The other auditors who audited the Housing Authority (Authority) reported the following significant deficiencies:

2014-06

General Ledger Maintenance

Condition: Financial information relating to bank reconciliations, inter-program transactions, and portability payments and balances were not recorded appropriately and/or reconciled in a timely basis.

Criteria: Adequate internal controls require accurate recording and periodic reconciliation of general ledger activity to ensure accurate financial reporting.

Cause: Employee turnover, ineffective procedures for recording and tracking of HCV portability transactions and other cash receipts.

Effect or Potential Effect: Additional year-end reconciliations and adjustments were necessary. Potential effect on interim financial reporting.

Recommendation: We recommend that financial activity for all balance sheet accounts be reconciled on a periodic basis to ensure accurate timely financial reporting. In addition, the Authority should modify the process for recording and tracking portability transactions and other cash receipts.

2014-07

Fixed Asset Recording and Capital Grant Reporting

Condition: Capital grant activity and the related Fixed Assets are not maintained in accordance with generally accepted accounting principles.

Criteria: Revenue is to be recognized when earned and assets capitalized in accordance with GAAP to facilitate accurate financial reporting.

Cause: Multiple staffing changes and capital grant activity being maintained on a budgetary basis whereas expenditures accumulate by grant and are recognized in the financials at year-end.

Effect or Potential Effect: Year-end closing entries were needed to accurately report capital expenditures and revenue. Interim and internal financial reporting does not reflect capital activity.

Recommendation: We recommend that capital grant activity be maintained in accordance with GAAP by modifying the Capital Grant chart of accounts to include revenue and expense accounts, whereby operating period activity can be tracked and reported as necessary. In addition, the Authority should consider automating the recognition of revenues to coincide with the recording of capital grant expenditures to assist in grant tracking and reporting in accordance with GAAP.

The other auditors who audited the Employee Benefits Trust reported the following significant deficiency:

2014-08

Medical Provider Overpaid

A medical provider was over-paid for capitation charges by the health plan administrator during the years 2011 through 2014 which was charged to the Maricopa County Employee Benefit Trust. The amount was approximately $1,000,000 for fiscal year 2014 and $5,000,000 for previous years dating back to 2011. This was an error caught by the provider and reported to Maricopa County. The refund was paid to Maricopa County Employee Benefits Trust in September 2014. A plan should be developed to periodically check that these overcharges do not occur in the future.

COUNTY RESPONSE

Maricopa County
Department of Finance

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February 9, 2015

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

2014-01
The County should follow its policies and procedures when valuing its capital assets
Contact person: Mark Modin, Finance Manager, Maricopa County Department of Transportation (MCDOT), (602) 506-8644
Anticipated Completion Date: Valuation error – Completed; Other errors: June 2015

Concur. The miscalculation of donated assets was due to a programming error in the custom software used to perform the annual calculations for Asset Management Reporting. The software code was corrected and future calculations will be accurate. In addition, MCDOT will perform a detailed review of valuation calculations. Further, MCDOT will implement procedures to work closely with Project Management staff to properly identify non-capital items within Construction in Progress (CIP), donated assets, and annexed projects.

2014-02
The County should follow its policies and procedures when preparing financial statement note disclosures
Contact person: John Lewis, Deputy Director, Department of Finance, (602) 506-1373
Anticipated Completion Date: June 2015

Concur: The noted items were due to clerical oversight. Although the jail per diem revenue billing and receivable schedules, financial statements and its disclosures, net position invested in capital assets were reviewed, the oversights were not initially discovered. All items were corrected prior to issuance of the financial statements. More detailed reviewed procedures will be implemented. The jail per diem billing function has since been transferred to the Sheriff's Department.

2014-03
The County should strengthen controls over cash receipts
Contact person: John Lewis, Deputy Director, Department of Finance, (602) 506-1373
Anticipated Completion Date: June 2015

Concur. The Department is currently updating its cash handling and deposit procedures to strengthen internal controls and ensure that all receipts are properly recorded and deposited. These procedures will include separation of duties, supervisory review, and detailed reconciliation processes.

2014-04
The County should monitor controls over its outside service organization
Contact person: Sandip Dholakia, Deputy Chief Information Officer – Advanced Services, (602) 506-1008.
Anticipated Completion Date: Completed

Concur: Office of Enterprise Technology established a Standard Operating Procedure on December 17, 2014, which outlines internal control procedures to obtain and review its outside service organization's audit reports.

2014-05
The County should strengthen its information system and network access controls
Contact persons: Office of Enterprise Technology: Sandip Dholakia, Deputy Chief Information Officer - Advanced Services, (602) 506-1008, and Kevin Westover, Deputy Chief Information Officer – Infrastructure and Communications Technology, (602) 506-1667; Treasurer: Jessica Perez, Systems Administrator and Analysis Manager, (602) 506-1966
Anticipated Completion Date: June 2015

Concur: Office of Enterprise Technology Concur will address the recommendation for the establishment and implementation of control procedures for the network, information systems, and data centers. Among other areas, the control procedures will address access to the general ledger system, Treasurer's finance system and network, and physical access to data centers.

The Treasurer's Office is currently completing an IT Operations Guide covering areas including Application Management, Security Management, and User Management. The guide specifies the procedures and step-by-step processes on adding/removing access to applications, an internal audit schedule of systems and access, and the creation and disabling of user accounts. The Treasurer's Office User Access Request form is also being modified to include a technical checklist of the procedures. A workflow process is being modified to better manage the submittal, approvals, completion, and verification of user account requests through which prevention of an issue such as this will be realized. We anticipate these updated procedures to be fully defined and in place by June 30, 2015.

Responses to other auditors' findings:

2014-06
Housing Authority of Maricopa County (HAMC): General Ledger Maintenance
Contact person: Mario L. Aniles, HAMC Finance Director, (602) 744-4517
Anticipated Completion Date: Completed

Concur. HAMC has fully implemented review and reconciliation of interprogram transactions and bank reconciliations on a regular basis. Financial activity for interprogram transactions are being reviewed and reconciled on a quarterly basis. Bank reconciliations are being performed on a monthly basis. All receipts of portability payments are now tracked separately in the general ledger and tied to bank reconciliations. The Agency has been implementing usage of the enterprise financial system to record and reconcile portability activity.

2014-07
Housing Authority of Maricopa County (HAMC): Fixed Asset Recording and Capital Grant Reporting
Contact person: Mario L. Aniles, HAMC Finance Director, (602) 744-4517
Anticipated Completion Date: Completed

Concur. HAMC has fully implemented procedures for grant tracking and reporting in accordance with GAAP.

2014-08
Employee Benefits Trust: Medical Provider Overpaid
Contact person: Dave Hansen, Benefits Finance Manager, (602) 506-2828
Anticipated Completion Date: Completed

Concur. We have developed a plan to comply with this finding by requiring Cigna to provide a detailed report of the makeup of the capitation expense charged monthly.

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