A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Report on Internal Control and Compliance

Maricopa County

Risk Management and Employee Benefits Trust Funds

Year Ended June 30, 2007

Debra K. Davenport
Auditor General

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Maricopa County
Risk Management and Employee Benefits Trust Funds
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

WILLIAM THOMSON
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 Maricopa County Risk Management and Employee Benefits Trust Funds as of and for the year ended June 30, 2007, and have issued our report thereon dated May 7, 2008. 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.

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 opinion on the 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 would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the County's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Funds' financial statements that is more than inconsequential will not be prevented or detected by the County's internal control. We consider item 07-01 described in the accompanying Schedule of Findings and Recommendations to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the County's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of the County's 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 disclosed an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards*, and which is described as item 07-02.

Maricopa County's responses to the recommendations identified in our audit have been included herein. 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, 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.

Dennis L. Mattheisen, CPA
Financial Audit Director

May 7, 2008

07-01
The County needs to ensure its Trust Funds' financial statements are accurate

The County and the Departments' management depend on accurate financial information to fulfill their oversight responsibility and report accurate information to the public and other interested parties. To achieve this objective, the County needs detailed policies and procedures over general ledger accounting to help ensure that the Funds' accounting records and financial statements are accurate. However, the County did not have detailed policies and procedures that addressed infrequent or unusual transactions such as when to record liabilities for medical incentive payments to healthcare providers or how to classify expense refunds. Specifically, the Employee Health Initiatives Department reported a $600,000 liability for a medical incentive payment to a healthcare provider in prior year financial statements even though it could not determine if the provider qualified for the incentive. Subsequently, the Department determined that the provider did not qualify for the incentive, did not pay the provider, and restated its July 1, 2006, net assets. Also, the Risk Management Department incorrectly classified almost $300,000 of refunds for prior year expenses as reductions of current year operating expenses rather than as other revenues. The Department adjusted its financial statements for this error.

To help ensure accurate financial reporting, the County should establish detailed policies and procedures instructing departments as to how to record certain infrequent or unusual transactions. In addition, the County should provide training to the various departments and monitor them to make sure they are following the procedures. The policies and procedures should include the following:

- Require the Employee Health Initiative Department to only record medical incentive payments as expenses and liabilities when providers have met their performance measures.

- Require the Risk Management Department to record refunds of current year expenses as reductions of those expenses and refunds of prior year expenses as other operating revenues.

7-02
The County must collateralize all deposits as required by statute

To protect public monies from potential loss, Arizona Revised Statutes (A.R.S.) §35-323 and the County's written policies and procedures require that eligible banks, before receiving a deposit from a governmental entity in excess of the federally insured amount, to pledge collateral equal to at least 101 percent of the deposit. However, the County did not always follow statute or its policy, since the County maintained Employee Benefits Trust Fund (Fund) balances in bank accounts that exceeded federal depository insurance. Specifically, at June 30, 2007, $1.3 million of the Fund's bank balance was uninsured and uncollateralized. No loss of public monies resulted from these uninsured and uncollateralized deposits.

To protect public monies from potential loss and to comply with statute and its policy, the County must ensure that all bank balances not covered by federal depository insurance are collateralized in accordance with A.R.S. §35-323.

Maricopa County
Employee Health Initiatives
Risk Management

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June 6, 2008

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

Dear Ms. Davenport:

The management of the Maricopa County Risk Management and Employee Benefits Trust Funds are 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 Report on Internal Control and Compliance very seriously. It is the intention of Maricopa County Trust Fund management to review the areas included in the Report on Internal Control and Compliance, determine, and implement the corrective actions(s) necessary. The following addressed the issues as discussed in the Report on Internal Control.

Recommendation 07-01:

The County needs to ensure its Trust Funds' financial statements are accurate.

County Response – Risk Management and Employee Health Initiatives concur with the finding. County Trust Fund management will implement internal control policies and procedures to 1) record current year refunds as a reduction of current year expenses and prior period refunds as other income, and 2) accrue liabilities for benefit plan incentives only when the performance measure criteria have been fully met by the health care provider by end of the reporting period.

Recommendation 07-02:

The County must collateralize all deposits as required by statute.

County Response – The Department of Finance is currently working with the Treasurer's Office to ensure that all County deposits are properly collateralized in accordance with A.R.S. §35-323. The County plans to be in compliance with A.R.S. §35-323 by the end of the current fiscal year.

If you have any questions or comments, please contact either of the Trust Fund management representatives below.

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Maricopa County, AZ
602-372-2837

cc: Shelby L. Scharbach
Deputy Finance Director