



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Procedural Review

Mohave County

Treasurer's Office

As of June 30, 2008



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

August 28, 2009

Melissa Havatone, Treasurer
Mohave County

Board of Supervisors
Mohave County, Arizona

We have performed a procedural review of the Mohave County Treasurer's Office internal controls over the investment of public monies in effect as of June 30, 2008. Our review consisted primarily of inquiries, observations, and selected tests of internal control policies and procedures, accounting records, and related documents. The review was more limited than would be necessary to give an opinion on internal controls. Accordingly, we do not express an opinion on internal controls or ensure that all deficiencies in internal controls are disclosed.

Specifically, we reviewed the Treasurer's Office policies over its investing activities and its compliance with laws and regulations for the procurement of investment services. We also performed limited tests of the more significant investment policies and related procedures to determine if the Treasurer's Office adhered to its established internal controls.

As a result of our review, we noted certain deficiencies in internal controls that the Treasurer's Office should correct to ensure that it fulfills its responsibility to establish and maintain adequate internal controls. Our recommendations concerning these deficiencies are described in the accompanying summary.

This letter is intended solely for the information and use of the Mohave County Treasurer's Office and Board of Supervisors and is not intended to be and should not be used by anyone other than these specified parties. However, this letter is a matter of public record, and its distribution is not limited.

Should you have any questions concerning our procedural review, please let us know.

Sincerely,

Debbie Davenport
Auditor General

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INTRODUCTION & BACKGROUND

The County Treasurer's primary responsibility is to manage the public monies of the County and related political subdivisions. Public monies include all monies in the County Treasury or coming lawfully into the Treasurer's possession or custody as prescribed by Arizona Revised Statutes (A.R.S.) §11-493. In addition to those monies required to be deposited with the County Treasurer, the governing body of any political subdivision may authorize the Treasurer to invest other monies on its behalf. Therefore, the Treasurer has a fiduciary responsibility to invest public monies to obtain the most benefit possible while minimizing the risk of loss. To maximize investment opportunities, the Treasurer may establish and maintain investment pools or, when requested by a political subdivision, it may invest certain amounts individually. A.R.S. §35-323 governs the types of investments and maximum maturities that the County Treasurer can invest in. Historically, the Mohave County Treasurer invested primarily in U.S. agency securities. However, in November 2007, the Mohave County Treasurer began investing in corporate bonds. At June 30, 2008, the Treasurer's investment portfolio had a value of \$194 million, including \$76 million invested in U.S. agency securities and \$49 million invested in corporate bonds.

The scope of our review was limited to the internal controls established by the County Treasurer over the investment of public monies. Our work was also limited as the Treasurer in office at the time of our review declined to meet with audit staff and the Deputy Treasurer primarily responsible for the investment function had resigned.

The County Treasurer's Office should improve controls over the safeguarding of investments

The Treasurer's Office is responsible for the safekeeping of all investments purchased and may enter into an agreement with an eligible depository's trust department for the safekeeping and handling of purchased securities. In accordance with A.R.S. §35-327.D, the Treasurer may, with the approval of the governing board, enter into an agreement with the trust department of any bank authorized to do trust business in this state for the safekeeping and handling of securities for which the Treasurer is lawful custodian. However, the County Treasurer's Office entered into agreements with investment firms for the safekeeping of investments without the Board of Supervisors' approval.

In addition, the Treasurer's Office had not properly separated the responsibility of purchasing investments from the responsibility of safekeeping investments. Specifically, auditors noted that the investment firm responsible for purchasing County investments was also responsible for the safekeeping of those investments. Strong internal controls to safeguard investments include having the purchasing and safekeeping responsibilities performed by different firms.

Because the Treasurer's Office invests monies directly in U.S. agency securities and corporate bonds rather than investing with the Arizona State Treasurer, it should have strong policies and procedures in place to safeguard investments. Specifically, the safekeeping agreement for investment securities should be approved by the County Board of Supervisors. Furthermore, the investment firm responsible for purchasing securities should be separate from the firm responsible for the safekeeping of the County's investments. Payments for investment securities purchased should only be made after the securities are delivered to the firm responsible for the safekeeping function.

The County Treasurer's Office should retain supporting documentation for its investing activities

The Treasurer's Office has established an investment policy to use prudence when investing public monies. However, at June 30, 2008, the Treasurer's Office did not retain supporting documentation to document that it complied with its investment policy. Specifically, auditors were not able to determine whether the Treasurer's Office purchased 11 corporate bonds totaling over \$50 million at the lowest price available

since there was no documentation that price quotes were obtained from various brokers prior to purchasing the bonds. Further, there was no documentation that the Treasurer's Office reviewed the investments' soundness or authorized the purchases.

The investment policy also stated that brokers wishing to do business with the County meet certain requirements. These requirements included membership in the National Association of Securities Dealers, Inc.; being licensed to engage in such business in the State of Arizona; being adequately financed to conduct government business; and completing a Broker/Dealer Request for Information form. In addition, county policy stated that no transactions will be conducted with a broker until all paperwork required by both parties was completed, which included the Treasurer notifying the broker that they had been approved in writing. However, for 8 out of 8 files selected for review, the Treasurer's Office did not retain documentation to support that the Treasurer had approved the broker or that the broker's qualifications had been reviewed.

To help ensure compliance with its established investment policy, the Treasurer's Office should retain the following documentation:

- Quotations from more than one broker to support that the County received the most advantageous price for the investment.
- Investment prospectuses and investment ratings to support that the Treasurer's Office evaluated the investment's soundness prior to purchase.
- Evidence that the Treasurer's Office reviewed and approved the broker to conduct county business.

The County Treasurer's Office should complete its written policies and procedures for investments

The Treasurer's Office has not completed its written policies and procedures for investing activities to help ensure that it complies with A.R.S. §35-323. Although the Treasurer's Office has an investment policy in place, the policy was vague and did not include policies and procedures for several key functions, including reconciling investment balances to monthly statements. As a result, reconciliations were not being performed promptly and auditors noted that over \$12,000 had been charged to the County that should not have been. The Treasurer's Office did not discover these erroneous charges until 8 months later. These charges were subsequently credited back to the County Treasurer's account. In addition, the Treasurer's Office did not have sufficient procedures in place to ensure that conflicts of interest did not exist with employees responsible for investing activities.

The Treasurer's Office should include the following subjects in its written policies and procedures:

- Definition of its policies for custodial credit risk, concentration of credit risk, and interest rate risk.
- Procedures and forms for reconciling investment balances to monthly statements.
- Methods for forecasting cash needs and determining investment amounts and durations.
- Assessment of controls over the investment software application including restrictions on access to the application.
- Process for identifying and documenting potential conflicts of interest.

The County Treasurer's Office should develop a systematic method to allocate investment earnings and losses

As required by A.R.S. §35-327.F, the Treasurer should allocate pooled income earnings on a pro rata basis to investment pool participants. Specifically, the *Uniform Accounting Manual for Arizona County Treasurers* (UAMACT) §IV-G-8 states that interest should be apportioned monthly or at least quarterly, and the Treasurer should use one of the methods described in the UAMACT or develop another reasonable, consistent method. However, at June 30, 2008, the Treasurer's Office did not have a systematic method in place to allocate investment earnings. As a result, the Treasurer's Office had not consistently allocated interest to its investment pool participants from October 2006 through June 2008.

Further, subsequent to June 30, 2008, auditors were notified that the Treasurer's Office was holding a \$5 million Lehman Brothers' corporate bond in its investment pool. Since Lehman Brothers filed for bankruptcy on September 15, 2008, it is unlikely that the Treasurer's Office will recover the bond's full purchase price; however, the Treasurer's Office continued to carry the bond at cost as they did not have a systematic method in place for allocating investment losses. Therefore, the County could suffer losses if participants make significant withdrawals since the true value of each participant's share had not been determined. In addition, participants were not aware of their reduced balances available for future expenditures.

To help ensure compliance with A.R.S. §35-327.F and UAMACT §IV-G-8, the Treasurer's Office should establish and implement a systematic method for allocating its investment earnings so that each pool participant is aware of his or her current balance. Examples of methods that can be used for interest allocation include:

- Average each pool participant's beginning and ending balances for the month and allocate interest proportionately.
- Allocate interest proportionately based on each participant's average daily balances.
- Allocate interest proportionately based on each participant's month-end balances for the 3 months in the quarter, if interest is apportioned quarterly.

In addition, if an investment loss or potential loss is known to the Treasurer's Office, the Treasurer's Office should have a method in place to allocate the loss to each pool participant at the loss measurement date and to notify pool participants of the loss so that they can record the loss in their accounting records. For example, one method may be to separate the troubled security into a separate pool so that it can be monitored and the remaining pool value will not be diluted.

COUNTY RESPONSE

COUNTY RESPONSE



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August 25, 2009

Debra K. Davenport
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Dear Ms. Davenport,

As the Mohave County Treasurer, I have chosen to respond to the procedural review letter of the Mohave County Treasurer's Office as of June 30, 2008. This review was performed under the prior Mohave County Treasurer administration and since I have taken office, procedures have been implemented as outlined in the following.

Letter Recommendation 1

Response:

A safekeeping account with Chase bank was opened and the safekeeping agreement was approved by the Board of Deposits. All securities were moved into this account. Transactions for trades are made through a separate investment DDA account with Chase. The payment for each transaction is made as the security is delivered into the safekeeping account. The Investment Advisors of Davidson Fixed Income Management are now working with the Treasurer but do not have access to the safekeeping account or the investment DDA account.

Letter Recommendation 2

Response:

Davidson (DFIM) handles all brokers/dealers who wish to do business with the Treasurer. Davidson has a standard broker/dealer questionnaire and retains all documentation on brokers/dealers where trades are completed.

Letter Recommendation 3

Response:

- A. The Administrative Policy 17-2, Mohave County Investment Policy has been approved and adopted by the Treasurer, the IOC (Investment Oversight Committee) and the Board of Deposits.
- B. Reconciling investments to a monthly statement is now in effect.
- C. Prior to structuring an investment portfolio with DFIM, a cash flow analysis was developed.
- D. Restrictions are in place with DFIM's software application.
- E. Refer to Administration Policy 17-2.

Letter Recommendation 4

Response:

Interest is allocated each month and the percentage for each participant is based on a monthly, daily average balance. Gains or Losses are figured in the monthly interest and allocated at the same time. Lehman Brothers loss was allocated and pool participants were notified of the loss. Lehman's troubled security has been placed as a separate pool.

We have taken these steps to prevent any future procedural discrepancies and to ensure proper investment and oversight of county funds. If you have any further questions, please contact me at your convenience.

Sincerely,

The Honorable Melissa Havatone
Mohave County Treasurer



