A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Report on Internal Control and Compliance

Pinal County

Year Ended June 30, 2008

Debra K. Davenport
Auditor General

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Pinal County
Report on Internal Control and Compliance
Year Ended June 30, 2008

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Report Issued Separately

Comprehensive Annual Financial Report

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
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
Pinal County, Arizona

We have audited the financial statements of the governmental activities, business-type activities, each major fund, and aggregate remaining fund information of Pinal County as of and for the year ended June 30, 2008, which collectively comprise the County's basic financial statements, and have issued our report thereon dated January 28, 2009. Our report was modified to include a reference to our reliance on other auditors and as to consistency because of the implementation of Governmental Accounting Standards Board Statement No(s). 45, 48, and 50. 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 Long Term Care Fund and Employee Benefit Trust, as described in our report on the County's financial statements. The financial statements of the Long Term Care Fund and Employee Benefit Trust were not audited by the other auditors in accordance with *Government Auditing Standards.* This report includes our consideration of the results of the other auditors' testing of internal control over financial reporting 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, 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 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 certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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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 County's basic financial statements that is more than inconsequential will not be prevented or detected by the County's internal control. We consider items 08-01 through 08-06 described in the accompanying summary to be significant deficiencies 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, of the significant deficiencies described above, we consider items 08-01 through 08-04 to be material weaknesses.

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 disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Pinal County's responses to the findings 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, management, 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

January 28, 2009

Pinal County
Schedule of Findings and Recommendations
Year Ended June 30, 2008

Financial Statement Findings

08-01
The County should strengthen access and program change controls over its general ledger financial accounting system

System access, both physical and logical, and program change controls are critical in preventing or detecting unauthorized use, damage, loss, or modification of programs and equipment, and misuse of sensitive information. The County needs these controls to protect and secure its general ledger financial accounting system as well as the information processed and stored on this system. However, because the County did not establish comprehensive policies and procedures or enforce its existing policies and procedures, did not always use existing controls built into this system, and did not consistently provide its employees with sufficient training, the general ledger financial accounting system and its sensitive information were at risk for misuse, modification, damage, or loss.

Specifically, the system information was at risk because the County gave some users access to unnecessary functions and, in some cases, gave users unnecessary unlimited access. For example, auditors identified two employees who had the ability to make changes to system programs and databases without independent review, and three employees who had the ability to change or manipulate data through unlimited access to various general ledger modules. Further, after giving county personnel their initial access, the County did not monitor changes in users' responsibilities to determine whether their access continued to be appropriate. Also, the County could not identify which users had initiated, approved, or processed individual transactions in the system.

The system and its information were also at risk because the computer room, where the system servers and other important hardware components are stored, was accessible to many employees who had no legitimate system responsibilities or need for this access. Further, system data stored on backup and recovery tapes was not encrypted to protect against unauthorized access to sensitive information. Additionally, the County could not identify when programs were changed and could not always provide documentation that program changes were authorized, properly tested, or independently reviewed and approved.

These deficiencies are considered to be a material internal control weakness.

To help safeguard sensitive electronic information on its general ledger financial accounting system, the County should establish comprehensive written policies and procedures for system access both physical and logical, and for program changes. These policies and procedures should separate incompatible responsibilities and should include the following:

- Establish user access only after appropriate supervisors have carefully reviewed and approved access requests. The supervisors should make sure the access rights are appropriate for the employee's job responsibilities.
- Eliminate permanent unlimited access for all users. If unlimited access is periodically given to a user for a specific purpose, another employee should monitor and review the user's activities.
- Modify the system to document which users initiated, approved, or processed individual transactions.

- Review an employee's access when their job responsibilities change and periodically review all employees' access to determine whether their access is still appropriate for their job responsibilities.
- Restrict physical access to servers and other important computer hardware components to employees who need access to perform their job responsibilities.
- Encrypt all stored backup data.
- Control and monitor all program changes.
- Document authorization, testing, and final approval of all program changes.

A similar recommendation was provided to the County in the prior year.

08-02
The Pinal County Treasurer's Office should strengthen controls over its computer system

The County Treasurer's Office manages deposits for county departments, school districts, and special districts. The principal duties include receiving, recording, safeguarding, investing, and disbursing monies for these entities. The County Treasurer currently processes nearly $1.1 billion of receipts, disbursements, and transfers of public monies each year. To account for these monies, the Treasurer's Office staff created, developed, and maintains a general ledger accounting system. For accountability and disclosure, it is essential that the Treasurer's general ledger accounting system have proper controls to manage these monies. Therefore, it is critical that the Treasurer's Office properly restrict and limit access to the financial data recorded on this system to enhance accountability, and safeguard assets and data. However, auditors noted that the County Treasurer's Office did not properly segregate employee responsibilities and access to the system. Specifically, two employees had unlimited access in the system, which included the ability to modify system programs and databases without independent review. One of these two employees was also the system developer and programmer and was heavily involved in the day-to-day operations of the Treasurer's Office. In addition, user access rights were granted to employees for incompatible roles and responsibilities; for example, one employee had the ability to create, record, review, and approve journal entries. Further, the Treasurer's Office did not monitor changes in users' responsibilities to determine if the employees' access rights were appropriate. Finally, the Treasurer's Office did not maintain audit log reports to help identify changes to the system and which system users initiated, processed, and approved individual transactions.

These deficiencies are considered to be a material internal control weakness.

To help safeguard the integrity of the information on the Treasurer's general ledger accounting system, the County Treasurer should strengthen policies and procedures to ensure that adequate segregation of duties exists and that no individual has control over the functions of authorization, recordkeeping, and asset custody. These policies and procedures should separate incompatible responsibilities and include the following:

- Eliminate unlimited access for all users. If unlimited access is periodically given to a user for a specific purpose, another employee should monitor and review the user's activities.
- System development and programming responsibilities should be performed by individuals not involved in the day-to-day operations of the Treasurer's office.

- Review an employee's access when their job responsibilities change and periodically review all employees' access to determine whether their access is still appropriate for their job responsibilities.
- Monitor key changes on the system by developing and maintaining audit log reports that contain key fields. In addition, the database administrator should follow best business practices and have read-only access to the audit log reports.

08-03
The County should develop and test a comprehensive disaster recovery plan

The County's computerized information systems process, record, and store information that is critical to their daily operations. Therefore, it is vital for the County to ensure that it can continue to operate in the event of a system or hardware failure by developing, implementing, and testing a disaster recovery plan. A properly designed disaster recovery plan helps ensure that proper procedures are in place to provide for continuity of operations and that electronic data files are not lost in the event of a disaster or other interruption. However, the County did not have comprehensive disaster recovery plans or a negotiated written backup agreement for the general ledger, Treasurer's system, or Housing system.

These deficiencies are considered to be a material internal control weakness.

To help ensure that the County can provide for the continuity of its operations and to help prevent loss of data in the event of a system or equipment failure or from a system interruption, the County should prepare a comprehensive disaster recovery plan that is updated and tested on a regular basis. This plan should include:

- A list of personnel assigned to disaster teams and emergency phone numbers for them.
- A risk analysis identifying the critical applications and exposures, and an assessment of the impact on the County.
- Specific operating procedures.
- Arrangements for a designated physical recovery facility.
- A formal equipment backup agreement covering machine time availability, application processing priorities, information exchanges regarding equipment configuration and system software changes, testing procedures, and costs.
- Restoration procedures for backup media (i.e., tapes and servers).
- An outline of overall testing strategies, establishing testing frequencies, and documentation of testing the disaster recovery plan.

In addition, the County should communicate and distribute copies of the disaster recovery plan to the necessary employees and ensure that they are aware of and are properly trained in their recovery responsibilities.

A similar recommendation was provided to the County in the prior year.

08-04
The County needs to ensure its financial statements are accurate

Accurate financial information reported in the County's financial statements is necessary to demonstrate accountability to the Board of Supervisors, federal and state grantors, and the public. To achieve this objective, management should ensure that its accounting records and financial reports are accurate and complete. However, the County did not achieve this objective because the County recorded some transactions incorrectly or did not properly report all of its note disclosures. Specifically, the County incorrectly recorded a year-end adjustment in the amount of $841,308 in their general ledger accounting system when attempting to transfer cash balances between funds. As a result of this error, the County presented an additional major fund on their preliminary financial statements that would not have otherwise met the quantitative criteria of a major fund. In addition, a $2 million loan was not reported in the notes to the financial statements. The County adjusted its financial statements and note disclosure for these errors.

These deficiencies are considered to be a material internal control weakness.

To help ensure the accuracy of the County's financial statements, all year-end adjustments, especially those that are unusual, should be reviewed and approved by someone other than the preparer, and funds that are identified as major or very close to the threshold should be analyzed for unusual balances to ensure proper recording of major funds. The County should also establish a process for compiling the information and preparing note disclosures to help ensure they are accurate and complete.

08-05
The County should establish procedures to accurately record donated roads.

The County's network of infrastructure assets includes donated subdivision roads. As required by the Governmental Accounting Standards Board Statement No. 34, donated property should be reported at fair value at the date the asset was donated. However, the County did not have policies and procedures to ensure that donated roads were properly valued. Auditors noted a number of instances where these donated subdivision roads were not properly valued in the County's accounting records, which resulted in a $77,835 error in the County's financial statements.

The County should develop written policies and procedures that describe the method for estimating the fair value of donated roads. In addition, the County should maintain adequate support for their cost determination and consistently apply the established method to help ensure that infrastructure is reported accurately in the financial statements.

08-06
The County needs to improve capital assets reporting for activity not recorded directly on the general ledger

Capital assets comprise over 69 percent of the County's total assets. Therefore, it is essential that the County accurately report these assets in its financial statements and maintain control over them. To accomplish this, the County must maintain a reliable capital assets system and have procedures in place that accurately identify, accumulate, and reconcile capital assets. To help ensure the completeness of its capital asset records, the County annually reconciles current year capital additions to capital expenditures. However, this reconciliation does not include departmental transactions that are not reported in the County's general ledger. For example, auditors noted a $5.3 million unreconcilable difference between the County's capital asset records and the Housing Department's records. However, auditors determined that most of the difference consisted of repair and maintenance costs, which should not have been capitalized on the Housing Department's system because the costs did not extend the estimated useful lives of the related capital assets.

To help the County ensure its capital assets are adequately accounted for, controlled, and accurately reported in its financial statements, the County should reconcile capital asset additions to capital expenditures, including capital expenditures of all County departments, annually and make all necessary corrections. In addition, the County should enforce its existing internal control policies and procedures that require each department to prepare and submit capital asset records to the Finance Department for newly acquired assets along with additions and betterments of existing assets in a timely manner.

Manuel González
Assistant County
Manager

Administrative
Services

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Terry Doolittle
County Manager

March 26, 2009

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

Dear Ms. Davenport:

The accompanying responses to the financial statement findings are providing you with the names of the contact persons responsible for corrective action, the corrective action planned, and the anticipated completion date for each audit finding included in the current year's financial statement findings.

Sincerely,

Yiannis Kalaitzidis, CPA
Finance Deputy Director

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Responses to Financial Statement Findings

08-01
The County should strengthen access and program change controls over its general ledger financial accounting system.
Contact Person: Richard Jones, Chief Information Officer
Anticipated completion date: 6/30/10

The county has recently established a procedure for initiating user access to the system. Department heads, elected officials or their delegates must approve new user access and any changes to existing user access, through the use of the system security administration form. This form is reviewed and approved by the Finance Department, and logical access is processed by Information Technology (IT) personnel based on approved paperwork. However, due to system and staffing limitations caused by the specialized technological knowledge requirements of the AS400 system we have not been able to address all the auditors concerns.

As a result, the county is in the process of evaluating a significant upgrade to the general ledger financial accounting system. As part of the evaluation, we are examining additional functionality that will allow the county to better control user access to the financial information, provide an audit trail that shows user activity on individual transactions and allows for monitoring and review of the user's activities. As part of this project, IT is developing a change management policy and procedure, which will be implemented once the new secondary AS400 environment is fully configured.

Further, IT will coordinate with the Human Resources department to establish a security review process that will address situations when employees change departments or roles within a department. In addition, IT is currently working with outside consultants to establish and coordinate review processes of individual access on a regular basis.

Physical access to the data center and disaster recovery site has been restricted only to staff members required to enter those facilities to perform their job responsibilities.

Finally, IT is investigating a backup software solution to accommodate backup tape encryption, as the current AS 400 system does not provide this feature.

08-02
The Pinal County Treasurer's Office should strengthen controls over its computer system.
Contact person: Maureen O'Connell, Chief Deputy Treasurer
Anticipated Completion date: 4/30/09

The Pinal County Treasurer's Office is committed to safeguarding all monies in its possession. Procedures have already been implemented to address the auditor's recommendations. Employee access has been updated and is now controlled through the use of a log by designated personnel. System development and programming responsibilities have been reassigned to a person not responsible for day to day operations and a journal log will be created to track all changes made to the Treasurer's computer system. The journal will log any changes made to key tables in the database and report directly to the Treasurer any access to these key files made outside the standard application or by unauthorized users. Finally, a procedure has been implemented to ensure that employee access is reviewed at least once a year, along with the employee's annual appraisal.

08-03
The County should develop and test a comprehensive disaster recovery plan.
Contact person: Richard Jones, Chief Information Officer
Anticipated completion date: 12/31/09

Pinal County Information Technology department is committed to providing the services and support systems necessary to conduct uninterrupted business under regular and irregular conditions. The Disaster Recovery Plan will provide summary detail on Pinal County's risk mitigation strategy, hardware, software and data recovery procedures, emergency response team members, facility location, and application recovery priorities for the financial applications running on the AS400 in the event a disaster strikes Building A.

The implementation of a Disaster Recovery Plan for the financial system has been delayed due to facility issues at the offsite disaster recovery location. The designated offsite facility issues located at 971 Jason Lopez Circle have been resolved and the County now has sufficient power and backup generator capacity to house the financial system in case a disaster strikes Building A allowing the ability to continue work on critical applications for the period of time required to bring in replacement hardware.

During the FY08-09 budget year it was determined that the AS400 would require a hardware upgrade and that the secondary AS400 would also require a hardware upgrade to accommodate business requirements. The secondary AS400 is being reconfigured to accommodate disaster recovery testing. Once this is complete the current Disaster Recovery Assessment for the AS400 and established Disaster Recovery template will be reevaluated due to the enormous growth and increased service demand on the financial system over the past several years.

Change management procedures are currently under development, some procedures have been implemented, and will be completed once the secondary AS400 environment is established.

08-04
The County needs to ensure its financial statements are accurate
Contact person: Yiannis Kalaitzidis, Finance Deputy Director
Anticipated completion date: 6/30/09

The County has updated internal financial statement preparation procedures that, among other items, include the review of year-end adjustments and analysis for significant transactions in all major funds. These procedures will be implemented during the upcoming financial statement preparation process.

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08-05
The County should establish procedures to accurately record donated roads.
Contact person: Tina Lawson, Business Manager
Anticipated completion date: 06/30/09

The County's Public Works Department will create a policy on the methodology for estimating the fair market value at the time of road donations to ensure all donated roads are accurately recorded.

08-06
The County needs to improve capital assets reporting for activity not recorded directly on the general ledger.
Contact person: Adeline Allen, Housing Director
Anticipated completion date: 06/30/09

The County's Housing Department will examine all existing records to verify the original value of all recorded capital assets maintained by the department. These values will be reconciled to the County's capital asset system information to ensure all capital assets maintained by the Housing Department are properly recorded. In addition, the Housing Department will submit information on newly acquired assets, or additions/improvements of existing assets at least annually, by the end of the County's fiscal year, to ensure all capital assets are properly presented in the County's financial statements.